



## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Fourth Quarter and Year Ended December 31, 2005

The following management's discussion and analysis of the financial condition and results of operations ("MD&A") of FNX Mining Company Inc. ("FNX" or the "Company") was prepared to enable a reader to assess material changes in the financial condition and results of operations of FNX as at and for the three month period and year ended December 31, 2005, in comparison to the corresponding prior-year periods. This MD&A is prepared as at March 30, 2006, and is intended to supplement and complement the audited consolidated financial statements of FNX for the years ended December 31, 2005 and 2004, which are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). This MD&A should also be read in conjunction with the most recent Annual Information Form ("AIF") on file with the Canadian provincial securities regulatory authorities. This MD&A contains certain forward looking statements based on management's current expectations (please see "Cautionary Note Regarding Forward Looking Statements" below). All references to dollars herein are in Canadian dollars unless otherwise specified. The Company has changed various accounting policies as outlined in "Financial Results – Change in accounting policies". As a result, all financial information related to 2004 and earlier within the AIF has been restated.

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#### Contents

|  |    |
|--|----|
| Executive Summary  | 1  |
| Key Economic Trends  | 4  |
| Financial Results  | 6  |
| Change in accounting policies                                  | 6  |
| Overview   | 6  |
| Summary of changes in the statement of operations – Table 1    | 6  |
| Business acquisitions and adjusted earnings – Table 2          | 7  |
| Metal Production and Sales                                     | 10 |
| Summary – Table 3  | 10 |
| Net change in sales revenue – Table 4                          | 12 |
| Cash operating cost per pound of nickel sold – Tables 5 and 6  | 13 |
| Cash operating margin per ton of ore sold – Table 7            | 14 |
| Other items in the statements of Operations                    | 14 |
| Adjusted EBITDA – Table 8                                      | 16 |
| Financial Condition and Liquidity                              | 16 |
| Cash and cash flows and other working capital items            | 16 |
| Property, plant and equipment – Tables 9 to 12                 | 17 |
| Share capital  | 22 |
| Reserves and Resources – Tables 13 and 14                      | 23 |
| Contractual obligations and commitments – Table 15             | 25 |
| Related Party Transactions                                     | 25 |
| Non-GAAP Performance Measures                                  | 26 |
| Critical Accounting Estimates                                  | 26 |
| Recent Accounting Pronouncements                               | 27 |
| Quarterly Financial Information                                | 27 |
| Summary of Selected Quarterly Financial Information – Table 11 | 28 |
| Quarterly Metal Production and Sales – Tables 17 and 18        | 29 |
| Quarterly Statements of Operations – Table 19                  | 31 |
| Risks and Uncertainties  | 32 |
| Corporate Governance   | 36 |
| Disclosure Controls  | 37 |
| Cautionary Note Regarding Forward Looking Information          | 38 |

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## Executive Summary

### Acquisitions and major developments

Following FNX's acquisition on July 1, 2005 of 100% of Aurora Platinum Corp. ("**Aurora**") and immediate subsequent disposition of 50% of Aurora to Dynatec Corporation ("**Dynatec**") (collectively the "**Aurora Transactions**"), FNX completed two other major transactions in the fourth quarter of 2005 – the October 21, 2005 acquisition of Dynatec's interests in Sudbury, thereby increasing FNX's ownership in its Sudbury properties to 100%, and the November 28, 2005 closing of a bought deal financing pursuant to which FNX issued 7,500,000 common shares for gross proceeds of \$102.0 million. These transactions have transformed the Company by quadrupling the size of the balance sheet, adding sufficient cash resources to permit FNX to undertake its capital exploration and development program in 2006 and allowing the Company to obtain 100% benefit from any future opportunities in the Sudbury Basin of Ontario.

On October 5, 2005, FNX announced that it had entered into an agreement with Dynatec whereby FNX would consolidate 100% ownership of its Sudbury assets (the "**Dynatec Transaction**"). On October 21, 2005, the Dynatec Transaction closed and FNX acquired Dynatec's 25% interest in the Sudbury Joint Venture (the "**SJV**") and its 50% interest in Aurora for the issuance by FNX of 20,500,000 of its common shares to Dynatec. The agreement also contains other terms including significant restrictions on the FNX common shares issued to Dynatec, including a three year voting trust, standstill and right of first refusal plus a requirement for broad distribution on the sale of the FNX shares. In addition, FNX has entered into a mine contractor services agreement whereby Dynatec will provide FNX with mine contractor services on the Sudbury properties until December 31, 2007. Dynatec will be paid a fee for such services. Management is of the view that the consolidation of these assets allows FNX to streamline and optimize its Sudbury assets and provides greater flexibility for FNX to pursue growth opportunities in the Sudbury mining district.

With the acquisition of Dynatec's interest in the former SJV and FNX acquiring 100% ownership and control of its Sudbury assets, the Company changed its accounting policy with respect to revenue recognition to better align FNX's accounting policies with its industry peers and is more reflective of the Company's evolution from a developing stage enterprise to a mid-tier producer. The change in accounting policy was applied retroactively and financial results and positions for all periods presented in the annual consolidated financial statements for 2005 and discussed in this MD&A have been restated in accordance with the changes in accounting policies which are more fully described below under Change in Accounting Policies.

### Operations

FNX mined and sold more tons of ore and produced more pounds of nickel and copper in the fourth quarter of 2005 than in either the fourth quarter of 2004 or the third quarter of 2005. The Company mined 124,169 tons of ore and shipped and sold 131,404 tons of ore resulting in the sale of 2.2 million pounds of nickel during the fourth quarter of 2005. FNX realized revenues of US\$5.77 per pound of nickel sold and had cash costs, net of by-product credits, of US\$3.11 per pound of nickel sold. The revenue per ton of ore sold was \$173 at a cash cost of \$122 per ton resulting in a cash operating margin per ton of ore sold of \$51. Nickel sales, along with significant by-product revenues from copper, platinum, palladium, gold and cobalt, resulted in



operating revenues of \$22.7 million. Mine cash operating costs for the quarter totaled \$16.0 million, providing a cash operating margin of \$6.7 million.

For 2005, FNX mined and sold more tons of ore and produced more pounds of nickel and copper than in 2004. The Company mined 442,886 tons of ore and sold 437,376 tons of ore resulting in the sale of 8.0 million pounds of nickel and 6.2 million pounds of copper. In 2005, FNX realized revenues of \$6.56 per pound of nickel sold and had cash costs, net of by-product credits, of US\$3.17 per pound of nickel sold. The revenue per ton of ore sold was \$193 at a cash cost of \$118 per ton resulting in a cash operating margin per ton of ore sold of \$76. Nickel sales, along with significant by-product revenues from copper, platinum, palladium, gold and cobalt, resulted in operating revenues of \$84.6 million and mine cash operating costs for 2005 totaled \$51.5 million, providing a cash operating margin of \$33.1 million.

As a result of a non-cash loss of \$3.3 million on the sale of a 50% interest in Aurora to Dynatec, FNX's net earnings for the year were reduced by \$3.3 million, or \$0.06 per share. Adjusting for this unusual item, FNX reports Adjusted Earnings of \$7.9 million for the year, equal to \$0.14 per share. Cash balances and working capital were \$152.5 million and \$153.2 million, respectively, at December 31, 2005 and the Company continued to be debt free.

The main focus of the FNX exploration program during the quarter continued to be the high grade copper-nickel-platinum-palladium-gold discoveries in the footwall of the Levack Mine. Drilling from surface (3 drills) and underground platforms (3 drills) during the fourth quarter of 2005 continued to expand the Levack Footwall Deposit, first reported in February 2005. Press releases in 2005 documented the progress of this program and suggested that a potentially significant deposit has been discovered. Updated information was released subsequent to year end and further results will be released on a continuing basis. While the available data are insufficient to determine resources/reserves of the Levack Footwall Deposit, strong borehole UTEM (University of Toronto Electromagnetic) and RIM (Radio Imaging Method) anomalies indicate that the deposit extends beyond the boundaries of the area drilled to date. The Levack Footwall Deposit bears many similarities, particularly the geological setting and mineralogy, with other currently producing footwall-type deposits in the Sudbury mining district. Three other footwall zones in proximity to the Levack Footwall Deposit are being drilled and their relationship to the Footwall Deposit is being investigated. A great deal of additional drilling is required to determine the deposit's size and economic potential. Access options to the Footwall Deposit are being considered. The drilling on the Aurora properties was initiated and will continue in 2006.

Mining at the Inter Main and PM Deposits of the McCreedy West mine continued in the fourth quarter. Ore sold from the PM Deposit at McCreedy West was included in revenue in the statement of operations starting with May 2005. The rehabilitation of the #1 and #2 shaft compartments at Levack has been completed to the 1860 level with rehabilitation done on four levels. A decision has been made to rehabilitate the shaft to the 2650 level. Shaft sinking at Podolsky continued with 373 feet of advance in the quarter and the shaft reached a depth of 1,772 feet by the end of the year. Excavation of the 1750 level station reached 32 feet by the end of the year.

There were no lost time accidents in the fourth quarter of 2005 at McCreedy West and the Levack and Podolsky projects were lost time incident free. In light of the increased number of personnel, a second full-time health and safety coordinator was hired. A public information session was held in November to update local residents on the activities at both the McCreedy West and Levack mine sites. Over 100 local residents attended this meeting and the Company



was complimented on its openness. Liaison as part of our memorandum of understanding is continuing on a regular basis with the Whanapitae First Nation at Podolsky. There were no reportable environmental incidents in the quarter. During 2005, McCreedy West initiated the development of an ISO 14001 compatible Environmental Management System and an OHSAS 18001 compatible Health and Safety Management System with an implementation date of December 2006.

## **Key Economic Trends**

FNX's financial performance has been and is expected to continue to be closely linked to the price of nickel and, to a lesser extent, the price of copper and other metals (platinum, palladium, gold and cobalt) produced by the Company. Nickel accounted for approximately 64% of the Company's mine operating revenues in the fourth quarter of 2005, a decline from the 77% in the third quarter of 2005 and 96% in the fourth quarter of 2004. Copper accounted for 22% of revenues in the fourth quarter of 2005 an increase of 15% from the fourth quarter of 2004 as production continues to ramp up from the PM Deposit. The balance of FNX's revenues comes from the by-product production of platinum, palladium, gold and cobalt. These by-products contributed 14% of FNX's revenues in the fourth quarter of 2005 and 9% for the year, compared to 3% and 5% for the fourth quarter and year 2004.

### **Nickel**

The cash settlement price of nickel on the London Metal Exchange ("LME") fluctuated considerably in 2005, having opened the year at US\$6.37 per pound, reaching a high of US\$8.05 per pound on May 12, 2005 and a low of US\$5.22 per pound on November 1, 2005 and closing the year at US\$6.07 per pound. The LME nickel price averaged US\$5.73 per pound in the fourth quarter of 2005, compared to an average of US\$6.61 per pound in the third quarter of 2005 and US\$6.39 per pound in the fourth quarter of 2004, respectively. The LME cash settlement price on December 31, 2005 was US\$6.07 per pound and averaged US\$6.68 for the 2005 year, compared to an average price of US\$6.28 per pound in 2004. The LME average cash settlement price per pound of nickel has been higher year over year for the past five consecutive years increasing as follows: 2001 - US\$2.70; 2002 - US\$3.07; 2003 - US\$4.37; 2004 - US\$6.28; and 2005 - US\$6.68. Nickel prices have increased in the first quarter of 2006 and averaged US\$6.70 per pound during January and February 2006 and closed at US\$6.88 per pound on March 28, 2006.

Nickel prices remained well above historical levels in 2005 due to the growing importance of Chinese nickel demand, signs of improving world economy and a shortage of primary nickel sources. Long-term drivers are expected to be the sustainability of Chinese nickel demand growth, the global supply deficit, a declining US dollar and continuing high energy prices. In addition, AME Mineral Economics has stated that the depletion of scrap resources is expected to affect the price of nickel as such sources accounted for approximately 40% of available nickel in 2004 but have since been depleted due to the increase in nickel prices. World consumption of nickel grew by 2.8% in 2004 to 1.25 million tonnes. In 2005, consumption growth was severely constricted by a supply shortage, resulting in increasing prices. Growth in 2005 was concentrated in China, with China accounting for 60% of the total increase in world consumption between 1999 and 2004.

Management continues to be of the view that the LME average cash settlement price for nickel will continue to be volatile but strong. Each US\$1.00 change in the price per pound of nickel is



expected to generate a change in the Company's pre-tax earnings and cash flow from operating activities by approximately \$9.7 million.

### **Copper**

The LME average cash settlement price per pound of copper nickel has been higher year over year for the past five consecutive quarters increasing as follows: 2004Q4 - US\$1.40; 2005Q1 - US\$1.48; 2005Q2 - US\$1.54; 2005Q3 - US\$1.70; and 2005Q4 - US\$1.95. The LME cash settlement price for copper has continued to increase in the first quarter of 2006 and averaged US\$2.24 per pound from January 1 to March 28, 2006, closing that day at US\$2.43 per pound. Each US\$0.50 change in the price per pound of copper is expected to generate a change in the Company's pre-tax earnings and cash flow from operating activities by approximately \$5.9 million. Management is of the view that the LME average cash settlement price for copper will remain strong relative to historic prices.

### **Precious and other metals**

FNX produces by-product platinum, palladium, gold and cobalt. The price of platinum was US\$859, US\$968 and US\$1,065 per ounce on December 31, 2004, 2005 and March 28, 2006, respectively. The price of palladium was US\$183, US\$254 and US\$330 per ounce on December 31, 2004, 2005 and March 28, 2006, respectively. The price of gold was US\$438, US\$517 and US\$567 per ounce on December 31, 2004, 2005 and March 28, 2006, respectively. The price of cobalt was US\$18.50, US\$14.75 and US\$14.25 per pound on December 31, 2004, 2005 and March 28, 2006 respectively.

The contribution to FNX's revenues from the sale of platinum, palladium and gold is expected to increase in 2006, compared to 2005, as the Company produced 10,040 ounces of combined platinum, palladium and gold in 2005 and is budgeting to produce 40,000 ounces in 2006. Cobalt production in 2005 totaled 98,410 pounds and is budgeted at 55,000 pounds in 2006.

### **Foreign exchange**

FNX reports its financial results in Canadian dollars. While the Company's minesite operating costs and most exploration and administration costs are in Canadian dollars, revenues from metal sales and concentrating, smelting and refining costs are in US dollars. The Canadian dollar has appreciated relative to the US dollar during the quarter as the average rate for the fourth quarter of 2005 was \$1.17/US\$, compared to \$1.18/US\$ in the third quarter of 2005. The exchange rate for the fourth quarter of 2004 was \$1.22/US\$. The Canadian dollar has outperformed most major currencies in 2005. Many analysts are not expecting significant changes in the \$/US\$ exchange rate in 2006 due to Bank of Canada comments that a strong dollar relative to the US dollar would hamper economic growth in Canada. Each \$0.05 change in exchange rates is expected to generate a change in the Company's pre-tax earnings and cash flow from operating activities by approximately \$2.1 million.



## Financial Results

### Change in accounting policies

FNX has changed its accounting policy with respect to revenue recognition and the costing of broken ore underground. Revenue is now recognized at the time the ore is shipped, which is also the time that title transfers. The ore is sold under contracts that provide for final prices that are determined by quoted market prices in a period subsequent to the date of sale. Variations from the provisionally priced sales are recognized as revenue adjustments as they occur until the price is finalized. Revenue was previously recognized two months after shipment, being the date that the nickel and copper components were settled. FNX has also changed its accounting policy with respect to broken ore underground. In-process inventory will now be recognized only in respect of broken ore on surface reflecting the fact that the ore is not available for use until it reaches the surface. The Company feels that these changes better align FNX's accounting policies with its industry peers, and are more reflective of FNX's continuing evolution from a development stage enterprise to a mid tier producer. Both changes have been adopted retroactively in the Company's 2005 financial statements. As a result of the change in accounting policy for revenue recognition, FNX's revenues and, therefore, net earnings will be more volatile in 2006 and beyond as the impact of changing metal prices on provisionally priced sales is recorded in the subsequent periods.

### Overview

The following table presents a summary of and changes between FNX's Consolidated Statements of Operations for the periods ended December 31, 2005 and 2004.

|  | Three months ended |         |          | Year ended      |          |          |
|--|--------------------|---------|----------|-----------------|----------|----------|
|  | 2005               | 2004    | Change   | 2005            | 2004     | Change   |
|  | \$000s             | \$000s  | \$000s   | \$000s          | \$000s   | \$000s   |
| Mine operating revenues                | <b>22,726</b>      | 16,345  | 6,381    | <b>84,602</b>   | 60,411   | 24,191   |
| Mine operating expenses <sup>(1)</sup> | <b>(16,032)</b>    | (9,641) | (6,391)  | <b>(51,484)</b> | (35,510) | (15,974) |
| Margin                                 | <b>6,694</b>       | 6,704   | (10)     | <b>33,118</b>   | 24,901   | 8,217    |
| Mine amortization                      | <b>(3,205)</b>     | (1,802) | (1,403)  | <b>(8,768)</b>  | (6,415)  | (2,353)  |
| Mining, net                            | <b>3,489</b>       | 4,902   | (1,413)  | <b>24,350</b>   | 18,486   | 5,864    |
| Non-controlling interest               | -                  | (1,141) | 1,141    | <b>(4,738)</b>  | (4,282)  | (456)    |
| Earnings from operations               | <b>3,489</b>       | 3,761   | (272)    | <b>19,612</b>   | 14,204   | 5,408    |
| Corporate administration               | <b>(1,744)</b>     | (686)   | (1,058)  | <b>(5,226)</b>  | (3,398)  | (1,828)  |
| Exploration administration             | <b>(856)</b>       | (642)   | (214)    | <b>(2,915)</b>  | (1,970)  | (945)    |
| Capital taxes                          | <b>(1,135)</b>     | (21)    | (1,114)  | <b>(1,135)</b>  | (186)    | (949)    |
| Depreciation                           | <b>(31)</b>        | (27)    | (4)      | <b>(89)</b>     | (101)    | 12       |
| Stock-based compensation               | <b>(342)</b>       | (10)    | (332)    | <b>(1,068)</b>  | (874)    | (194)    |
| Loss on disposition                    | -                  | -       | -        | <b>(2,600)</b>  | -        | (2,600)  |
| Taxes                                  | <b>(1,314)</b>     | (851)   | (463)    | <b>(4,721)</b>  | (2,500)  | (2,221)  |
| Other (expenses) income                | <b>2,410</b>       | 804     | 1,606    | <b>2,739</b>    | 822      | 1,917    |
| Net earnings (loss)                    | <b>477</b>         | 2,328   | (1,851)  | <b>4,597</b>    | 5,997    | (1,400)  |
| Basic and diluted EPS                  | <b>\$0.01</b>      | \$0.05  | (\$0.04) | <b>\$0.08</b>   | \$0.12   | (\$0.04) |

<sup>(1)</sup> Mine operating expenses exclude mine depreciation and amortization.



Operating revenues were \$22.7 million in the fourth quarter of 2005, 39% higher than in the fourth quarter of 2004, and were \$4.1 million, or 22%, higher than in the third quarter of 2005. FNX had net earnings of \$0.5 million, equal to \$0.01 per share for the quarter, compared to net earnings of \$2.3 million or \$0.05 per share for the same quarter last year. FNX's cash position at December 31, 2005 was \$152.5 million, \$95.0 million more than at September 30, 2005 and \$95.7 million more than at December 31, 2004. Working capital was \$153.2 million, an increase of \$73.9 million from September 30, 2005 and \$82.8 million from December 31, 2004.

Operating revenues were \$84.6 million for the year, approximately 40% higher than in 2004. Net earnings were \$4.6 million, equal to \$0.08 per share for the year, compared to \$6.0 million, or \$0.12 per share, of net earnings in 2004. Cash flow from operating activities was \$27.2 million, equal to \$0.47 per share for the year, and was 109% higher than the \$13.0 million, or \$0.26 per share in 2004.

### **Business acquisitions and adjusted earnings**

#### *Aurora transactions*

On July 1, 2005, FNX completed the acquisition of all of the issued and outstanding common shares of Aurora, pursuant to an agreement announced on May 4, 2005. FNX issued 4,270,803 common shares to acquire a 100% interest in Aurora. Aurora's principal assets are its 70% joint venture interest in the Falconbridge Mine Property located in the Sudbury mining district, interests in two publicly listed, junior mining corporations, Lake Shore Gold Corp. ("Lake Shore") and Superior Diamonds Inc. ("Superior"), and its nickel-copper-platinum group metals exploration properties in northwestern Quebec, northwestern Ontario and the Timmins area of Ontario. In a related but independent transaction that also closed on July 1, 2005, pursuant to an agreement dated May 18, 2005 with FNX's Sudbury Joint Venture ("SJV") partner, Dynatec, FNX agreed to sell to Dynatec 50% of the Company's interest in Aurora for cash proceeds of \$12.2 million and the issuance by Dynatec to FNX of 7,716,594 common shares of Dynatec. Management is of the view that the mineral properties held by Aurora in the Sudbury mining district have significant exploration potential for the discovery of nickel-rich contact-type deposits and copper-nickel-platinum-palladium-gold footwall-type deposits similar to the mineralization discovered by FNX at Levack Footwall.

Notwithstanding that the acquisition of a 100% interest in Aurora on July 1, 2005 and the immediate subsequent disposition of a 50% interest in Aurora to Dynatec were essentially simultaneous transactions, accounting rules require these transactions to be handled separately.

For purposes of the acquisition of 100% of Aurora the weighted average fair value price of the shares of FNX was \$9.27 as at May 4, 2005, the date the agreement of the transaction was announced, which would have resulted in an ascribed fair value for accounting purposes of \$39.6 million as at that time. Purchase accounting rules, however, require FNX to fair value the 4,270,803 common shares issued to shareholders of Aurora at \$11.64 per share, being the weighted average share price of FNX for the day of, the two business days before and the two business days after the date of determination of the ultimate number of shares of FNX to be issued, which date was June 15, 2005. Accordingly, for accounting purposes, the fair value of the shares of FNX issued was \$49.7 million, excluding transaction costs of \$0.7 million. This fair value amount was ascribed to the net assets acquired.



Also on July 1, 2005, FNX sold to Dynatec a 50% interest in Aurora with an accounting cost base of \$25.2 million, being half of the fair value of the FNX shares issued to acquire Aurora as described above. The consideration received from Dynatec was \$12.2 million in cash and 7,716,594 common shares of Dynatec. As the Dynatec transaction was independent of the acquisition of Aurora, for accounting purposes, the fair value of the shares received from Dynatec at the date the transaction closed was \$1.30 per share for a total fair value of \$10.0 million. The fair value of cash and share proceeds received from Dynatec, therefore, totaled \$22.6 million. Accordingly, for accounting purposes, FNX recorded a one-time, pre-tax, non-cash loss on the sale to Dynatec, of \$2.6 million, being the difference between the \$22.6 million of fair value proceeds received and FNX's \$25.2 million of fair value costs. In addition, as a result of the difference between the values of the Dynatec shares for accounting and tax purposes, a further future income tax expense of \$0.7 million was charged to earnings.

The following table presents a reconciliation of and changes between FNX's Consolidated Adjusted Earnings, a non-GAAP performance measure (please see discussion under Non-GAAP Performance Measures below), for the three month periods and years ended December 31, 2005 and 2004, whereby FNX's GAAP earnings are adjusted for the one-time, non-cash loss resulting from the sale in July 2005 of a 50% interest in Aurora to Dynatec.

|                            | <b>Three months ended<br/>December 31</b> |        |          | <b>Year ended<br/>December 31</b> |        |         |
|----------------------------|---|--------|----------|-----------------------------------|--------|---------|
|                            | <b>2005</b>                               | 2004   | Change   | <b>2005</b>                       | 2004   | Change  |
|                            | <b>\$000s</b>                             | \$000s | \$000s   | <b>\$000s</b>                     | \$000s | \$000s  |
| Net earnings               | <b>477</b>                                | 2,328  | (1,851)  | <b>4,597</b>                      | 5,997  | (1,400) |
| Loss on disposition        | -   | -      | -        | <b>2,600</b>                      | -      | 2,600   |
| Tax on loss on disposition | -   | -      | -        | <b>687</b>                        | -      | 687     |
| Adjusted net earnings      | <b>477</b>                                | 2,328  | (1,851)  | <b>7,884</b>                      | 5,997  | 1,887   |
| Adjusted Basic EPS         | <b>\$0.01</b>                             | \$0.05 | (\$0.04) | <b>\$0.14</b>                     | \$0.12 | \$0.02  |

As per the above, FNX's Adjusted Earnings show an improvement from 2004 to 2005 as strong growth in the Company's production levels resulted in higher year over year Adjusted Earnings.

#### *The Dynatec Transaction*

On October 5, 2005, FNX announced the Dynatec Transaction. The transaction closed on October 21, 2005. The material terms of the transaction are as follows:

- (i) FNX acquired Dynatec's 25% interest in the SJV and 50% interest in Aurora;
- (ii) FNX issued 20,500,000 common shares to Dynatec;
- (iii) FNX and Dynatec entered into a Voting Trust agreement with a term of three years pursuant to which votes attached to the common shares held by Dynatec will be voted in line with recommendations of the board of directors of FNX on various fundamental changes and initiatives (including, among other matters, mergers, acquisitions and the nomination of directors to the FNX board), such agreement ceasing to be in effect should Dynatec's ownership stake in FNX decline below 10% on a fully-diluted basis;

- (iv) FNX was provided with a right of first refusal in the event that Dynatec wishes to distribute any of the common shares that it holds, which will permit FNX to designate the purchasers of common shares to be sold by Dynatec for a period of 10 business days at a price acceptable to Dynatec (net of commissions) which, in the event of a sale by way of a prospectus, shall not exceed 95% of the volume weighted average of the trading prices of the common shares on the Toronto Stock Exchange for the five trading days immediately prior to receipt of written notice from Dynatec of its election to sell such common shares (the “**VWAP**”) and, in the event of a sale that will not be done by way of a prospectus, shall not exceed the VWAP, and if FNX elects not to exercise its right of first refusal or is unable to arrange for the sale of the common shares in accordance with terms attaching thereto, Dynatec may, for a period of 90 days thereafter, enter into an underwriting agreement to sell such common shares through a public distribution in Canada and, if a prospectus is required in connection with such sale, FNX will take such reasonable steps, at Dynatec’s cost, as are necessary to qualify by prospectus in Canada the distribution of such common shares;
- (v) Dynatec was provided with representation on FNX’s board of directors that is the greater of two nominees and that number of nominees that is equal to Dynatec’s fully diluted ownership position, for a period of three years (such representation being dependent upon Dynatec maintaining an ownership stake in FNX of at least 10% on a fully-diluted basis);
- (vi) FNX agreed to purchase, at the option of Dynatec, \$10.0 million of Dynatec’s common shares in the next Dynatec offering of common shares to the public at the issue price of the offering, provided that the offering is for a minimum of \$100.0 million and is completed before October 21, 2006; however, Dynatec subsequently completed a common share offering of in excess of \$100.0 million without exercising their option and, accordingly, the Dynatec option described herein has fallen away;
- (vii) Dynatec will provide contractor mining services at the Sudbury properties until December 31, 2007, subject to FNX having approval, control and direction over the services provided by Dynatec. Under the mining services agreement, Dynatec will be paid a fee of 7% on a cost reimbursement basis; and
- (viii) Dynatec is to be paid \$7.5 million on each of December 31, 2006 and 2007 as deferred payment obligations.

The total purchase consideration of \$300.3 million was satisfied by the issuance of 20,500,000 common shares of FNX, the deferred payment obligations to Dynatec of \$7.5 million on each of December 31, 2006 and 2007, plus cash transaction costs of \$1.1 million. The 20,500,000 common shares issued by FNX to Dynatec had an ascribed value for accounting purposes of \$13.90 per common share (based upon the volume weighted average trading price of FNX’s shares for the day of, the two trading days before and the two trading days after October 5, 2005, the date of the announcement of the transaction). Accordingly, the share consideration totaled \$285.0 million. The discounted value of the two \$7.5 million payments to Dynatec is \$14.2 million. An independent valuation of the mining and mineral exploration properties was completed and the purchase price was accordingly allocated to the mineral properties. The ascribed value of the mineral properties acquired was greater than the mineral properties’ tax values. Accordingly, a future income tax liability of \$133.2 million was accrued.

## Metal Production and Sales

The following table presents a summary of FNX's metal production and sales information for the periods ended December 31, 2005 and 2004.

| Table 3                        | Three months ended |        | Year ended     |         |
|--------------------------------|--------------------|--------|----------------|---------|
|                                | 2005               | 2004   | 2005           | 2004    |
| Ore (tons)                     |                    |        |                |         |
| Mined                          | <b>124,751</b>     | 82,213 | <b>442,866</b> | 304,797 |
| Sold                           |                    |        |                |         |
| Nickel ore                     | <b>84,358</b>      | 78,740 | <b>326,651</b> | 291,780 |
| Copper ore                     | <b>47,046</b>      | 3,552  | <b>110,716</b> | 14,988  |
| Total ore                      | <b>131,404</b>     | 82,292 | <b>437,367</b> | 306,768 |
| Grade of ore sold              |                    |        |                |         |
| Nickel ore (%Ni)               | <b>1.6</b>         | 1.7    | <b>1.7</b>     | 1.6     |
| Copper ore (%Cu)               | <b>2.1</b>         | 5.1    | <b>2.6</b>     | 5.7     |
| Payable metal sold (000s lbs)  |                    |        |                |         |
| Nickel                         | <b>2,151</b>       | 1,843  | <b>8,018</b>   | 6,587   |
| Non-controlling interest       | -                  | (461)  | <b>(1,467)</b> | (1,647) |
| Net to FNX                     | <b>2,151</b>       | 1,382  | <b>6,551</b>   | 4,940   |
| Copper                         | <b>2,053</b>       | 638    | <b>6,211</b>   | 2,643   |
| Non-controlling interest       | -                  | (160)  | <b>(1,040)</b> | (661)   |
| Net to FNX                     | <b>2,053</b>       | 478    | <b>5,171</b>   | 1,982   |
| Metal sales revenue            |                    |        |                |         |
| Average Ni price (US\$/lb)     | <b>5.77</b>        | 6.53   | <b>6.56</b>    | 6.21    |
| Average Cu price (US\$/lb)     | <b>2.07</b>        | 1.45   | <b>1.73</b>    | 1.34    |
| \$/US\$ exchange rate          | <b>1.17</b>        | 1.22   | <b>1.21</b>    | 1.30    |
| Total revenue (\$000s)         | <b>22,726</b>      | 16,345 | <b>84,602</b>  | 60,411  |
| Revenue (\$/ton of ore sold)   | <b>173</b>         | 199    | <b>193</b>     | 197     |
| Cash cost of metals sold       |                    |        |                |         |
| Mining (\$000s)                | <b>16,031</b>      | 9,641  | <b>32,973</b>  | 35,510  |
| Cash cost (US\$/lb of Ni sold) | <b>3.11</b>        | 3.54   | <b>3.17</b>    | 3.28    |
| Cash cost (\$/ton of ore sold) | <b>118</b>         | 117    | <b>122</b>     | 116     |

- Notes:
1. All production figures are shown on a 100% basis with Dynatec's 25% interest shown as non-controlling interest.
  2. Mined relates to ore that was mined from McCreedy West and brought to surface during the three month and twelve month periods ended December 31, 2005 and 2004, respectively, and includes 83,860 tons of ore mined from the PM Deposit at McCreedy West from May to December 2005.
  3. Tons of ore, grade and payable metal sold relate to ore that was mined from McCreedy West, was shipped to Inco and was, accordingly, recognized in revenue during the three month and twelve month periods ended December 31, 2005 and 2004, respectively, and includes 83,010 tons of ore from the PM Deposit at McCreedy West sold from May to December 2005.
  4. Cash operating cost per pound of nickel sold excludes mine depreciation and amortization and includes mining, milling, smelting, refining, haulage and marketing costs and is net of by-product credits.
  5. Copper grades reflect a blend of lower grade PM Deposit ore with higher grade ores from other zones.



### *Metal sales*

Nickel sales in the fourth quarter of 2005 were 308,000 pounds more, or 17% higher, than in the same period of 2004, and were 353,000 pounds more than in the third quarter of 2005. The 17% increase in pounds of nickel sold in this quarter compared to 2004 was due to more tons of nickel ore being sold at a higher grade. The 353,000 more pounds of nickel sold in the fourth quarter as compared to the third quarter of 2005 was due to 19,609 more tons of combined nickel and copper ores being sold, which more than offset the lower nickel grades. Copper sales in the fourth quarter were 1,415,000 pounds more than in the same period in 2004, and were 709,000 pounds higher than in the third quarter of 2005. The 222% increase in pounds of copper sold in this quarter compared to 2004 was due to more tons of copper ore being sold which more than offset the lower average copper grades. The 53% increase in pounds of copper sold in the fourth quarter as compared to the third quarter of 2005 was due to 9,867 more tons of copper ore being sold at higher average copper grade. More tons of ore were sold in the fourth quarter of 2005 than in the fourth quarter of 2004, as the McCreedy West Mine was still in the process of ramping up production from the Inter Main Deposit in 2004. Production of ore in the fourth quarter of 2005 was higher than in the third quarter of 2005 as production from the PM Deposit continues to ramp up at McCreedy West.

Nickel sales for the year ended December 31, 2005 were 1,431,000 pounds higher than in 2004. The 22% increase in pounds of nickel sold was due to 34,871 more tons of nickel ore being sold this year. Copper sales for 2005 were 1,943,000 pounds higher than in the same period in 2004. The 112% increase in pounds of copper sold this year was due to a combination of 29,704 more tons of copper ore being sold along with lower average copper grades from the PM Deposit. Production levels were higher in 2005 than in 2004 for the reasons discussed above.

FNX plans to ship 635,000 tons of production and pre-production ore in 2006, 38% higher than in 2005, and to have payable metal production of 8.1 million pounds of nickel, 9.7 million pounds of copper, 55,000 pounds of cobalt and 40,000 combined ounces of platinum, palladium and gold.

### *Metal sales revenue*

The nickel and copper contained in the ore that FNX sells to Inco for further processing each month is priced at and ultimately paid to FNX on the basis of the lower of the month's average LME cash settlement price and the monthly average LME three month seller price. FNX's average realized nickel price was US\$5.77 per pound and US\$6.28 per pound of nickel sold in the fourth quarter and year 2005, respectively, compared to US\$6.39 per pound and US\$6.56 per pound, respectively, last year. As discussed in the Executive Summary section of this MD&A, management is of the view that nickel prices will be volatile but should remain high in 2006 relative to historic averages.

The realized nickel price in the fourth quarter of 2005 was lower than that realized in the fourth quarter of 2004 and the third quarter of 2005. The 8% appreciation in the value of the Canadian dollar relative to the US dollar resulted in lower nickel sales revenue in Canadian dollars than would otherwise have been realized. More pounds of nickel were sold in all the comparable periods listed in the table below. The decline in the nickel prices from the third quarter to the fourth quarter of this year resulted in \$1.7 million less sales revenue in the fourth quarter, while for the year resulted in \$0.6 million less sales revenue.



The following table shows the increase (decrease) in FNX's nickel sales revenue (in Canadian dollars) as a result of an increase (decrease) in the quantity of nickel sold and the price of nickel earned by comparing the fourth quarter and year 2005 to previous periods.

| <b>Table 4</b>                                       | Q4-2005<br>compared to<br>Q4-2004 | YTD-2005<br>compared to<br>YTD-2004 | Q4-2005<br>compared to<br>Q3-2005 |
|--|-----------------------------------|-------------------------------------|-----------------------------------|
|  | \$000s                            | \$000s                              | \$000s                            |
| <u>Increase (decrease) in nickel sold:</u>           |                                   |                                     |                                   |
| <i>Number of pounds sold (000s lbs)</i>              | 308                               | 1,432                               | 353                               |
| Change in revenue due to quantity                    | 2,537                             | 11,510                              | 2,672                             |
| <i>Price per pound sold (US\$/lb)</i> <sup>(1)</sup> | (0.76)                            | (0.38)                              | (0.52)                            |
| Change in revenue due to price                       | (2,205)                           | (574)                               | (1,706)                           |
| Net change in sales revenue                          | 332                               | 10,936                              | 966                               |

<sup>(1)</sup> The price of nickel is quoted in US dollars. FNX, however, reports revenue in Canadian dollars. As a result of the approximately 8% appreciation in the Canadian dollar compared to the US dollar from the fourth quarter of 2004 to the fourth quarter of 2005, the increase in the price per pound of nickel in Canadian dollar terms has not been as large as the increase in US dollar terms. The effect of changes in the Canadian dollar-US dollar exchange rate realized by FNX has not been separately identified in the table above.

#### *Mining cost of sales*

Mine operating expenses excluding mine depreciation and amortization costs ("cash operating costs") were \$16.0 million in the fourth quarter of 2005, compared to \$9.6 million in the fourth quarter of 2004. FNX's cash operating cost per pound of nickel sold, a non-GAAP performance measure (please see discussion under non-GAAP Performance Measures below), was US\$3.11 for the quarter, US\$0.43 per pound lower than in the fourth quarter of 2004 and US\$0.24 per pound lower than in the third quarter of 2005. Cash operating costs were \$6.4 million higher in the fourth quarter of 2005 compared to 2004 due to the significantly higher number of pounds of nickel and copper sold as a result of the higher number of tons of ore in 2005. The cash operating cost per pound benefited from higher by-product credits in 2005 as well.

Mine cash operating costs were \$51.5 million for the year 2005, compared to \$35.5 million in 2004. FNX's cash operating cost per pound of nickel sold was US\$3.17 per pound for the full year 2005, US\$0.11 per pound lower than in 2004. Mine cash operating costs were \$16.0 million higher in 2005 compared to 2004 due to the significantly higher number of tons of ore sold this year compared to last year. The unit costs were lower, however, due to the higher number of pounds of nickel sold and much higher by-product credits.

The following tables present the calculation of cash operating costs per pound of nickel sold:

|                                   | Three months ended<br>December 31, 2005 |                     |                    | Three months ended<br>December 31, 2004 |              |             |
|-----------------------------------|---|---------------------|--------------------|---|--------------|-------------|
|                                   | C\$000s                                 | US\$000s            | US\$/lb            | C\$000s                                 | US\$000s     | US\$/lb     |
| Operating expenses <sup>(1)</sup> | <b>16,031</b>                           | <b>13,663</b>       | <b>6.35</b>        | 9,641                                   | 7,901        | 4.29        |
| By-product credits:               |   |                     |                    |   |              |             |
| Copper                            | <b>(4,984)</b>                          | <b>(4,248)</b>      | <b>(1.97)</b>      | (1,122)                                 | (920)        | (0.50)      |
| Other <sup>(2)</sup>              | <b>(3,193)</b>                          | <b>(2,721)</b>      | <b>(1.27)</b>      | (554)                                   | (454)        | (0.25)      |
| Cash operating costs              | <b><u>7,854</u></b>                     | <b><u>6,694</u></b> | <b><u>3.11</u></b> | <u>7,965</u>                            | <u>6,527</u> | <u>3.54</u> |
| Nickel sold (000s lbs)            |   | <b><u>2,151</u></b> |                    |   | <u>1,843</u> |             |

|                                   | Year ended<br>December 31, 2005 |                      |                    | Year ended<br>December 31, 2004 |               |             |
|-----------------------------------|---------------------------------|----------------------|--------------------|---------------------------------|---------------|-------------|
|                                   | C\$000s                         | US\$000s             | US\$/lb            | C\$000s                         | US\$000s      | US\$/lb     |
| Operating expenses <sup>(1)</sup> | <b>51,483</b>                   | <b>42,513</b>        | <b>5.30</b>        | 35,510                          | 27,372        | 4.16        |
| By-product credits:               |                                 |                      |                    |                                 |               |             |
| Copper                            | <b>(12,930)</b>                 | <b>(10,677)</b>      | <b>(1.33)</b>      | (4,574)                         | (3,526)       | (0.54)      |
| Other <sup>(2)</sup>              | <b>(7,779)</b>                  | <b>(6,424)</b>       | <b>(0.80)</b>      | (2,876)                         | (2,217)       | (0.34)      |
| Cash operating costs              | <b><u>30,774</u></b>            | <b><u>25,412</u></b> | <b><u>3.17</u></b> | <u>28,060</u>                   | <u>21,629</u> | <u>3.28</u> |
| Nickel sold (000s lbs)            |                                 | <b><u>8,018</u></b>  |                    |                                 | <u>6,587</u>  |             |

(1) Operating expenses exclude mine depreciation and amortization.

(2) Platinum, palladium, gold and cobalt.

(3) Canadian dollars have been translated into US dollars using the average rate realized by FNX for the relevant period.

Total operating costs are expected to rise during 2006 as a result of increasing quantities of ore mined due to production from the PM Deposit. The PM Deposit's relatively higher copper and precious metals by-product content should result in higher by-product credits.

Mine depreciation and amortization expense was \$3.2 million in the fourth quarter of 2005, compared to \$1.8 million in 2004, as both the property, plant and equipment balance and number of tons of ore shipped to Inco were higher this year. Additional mine depreciation charges were incurred as a result of the significant increase in the carrying value of the McCreedy West mine from the Dynatec Transaction.

Mine depreciation and amortization expense will increase in 2006 with the increase in production rates as a result of the continuing ramping up of the PM Deposit and the additional amortization associated with higher carrying value of the McCreedy west mine from the Dynatec Transaction.

#### *Cash operating margin per ton of ore sold*

Cash operating margin per ton of ore sold, a non-GAAP performance measure (please see discussion under Non-GAAP Performance Measures below), was \$51 per ton in the fourth quarter of 2005, compared to \$82 per ton in 2004 and \$119 per ton and \$74 per ton in the second and first quarters of 2005, respectively. While higher tonnages of ore were sold in the



third quarter compared to the second quarter of 2005, they were at a lower realized Canadian dollar metal price, thereby contributing to the reduced cash operating margin per ton of ore sold.

The following table presents the calculation of cash operating margin per ton of ore sold <sup>(1)</sup> for the periods indicated.

| Table 7                                   | Three months ended |        | Year ended  |        |
|---|--------------------|--------|-------------|--------|
|   | December 31        |        | December 31 |        |
|   | 2005               | 2004   | 2005        | 2004   |
|   | \$/ton             | \$/ton | \$/ton      | \$/ton |
| Mine operating revenue                    | 173                | 199    | 193         | 197    |
| Mine operating expenses <sup>(2)</sup>    | (122)              | (117)  | (118)       | (116)  |
| Cash operating margin per ton of ore sold | 51                 | 82     | 75          | 81     |

(1) Components of the cash operating margin per ton of ore sold are calculated by dividing each of mine operating revenue and mine operating expenses, as per the statements of operations, by tons of ore sold.

(2) Mine operating expenses exclude mine depreciation and amortization.

With metal prices continuing to be high, grades forecasted to remain stable and increasing tonnages of lower margin ore mined from the PM Deposit, FNX anticipates that the cash operating margin per ton of ore sold will continue to be volatile.

### Other Items in the Statements of Operations

#### *Corporate and exploration administration*

Corporate administration expenses were \$1.7 million and \$5.3 million in the fourth quarter and year 2005, respectively, compared to \$0.7 million and \$3.4 million, respectively, in 2004. Due to the nature of exploration activities, exploration administration expenses are somewhat more volatile than corporate administration expenses and were \$0.9 million and \$2.9 million in the fourth quarter and year 2005, respectively, compared to \$0.6 million and \$2.0 million, respectively, in 2004. Corporate and exploration administration expenses were higher in the fourth quarter of 2005, primarily due to the addition of personnel to assist in facilitating the growth of FNX's business in 2005 and for bonuses accrued for exceeding corporate objectives for the year including the encouraging exploration results from the Levack Footwall discovery.

#### *Depreciation*

Depreciation expenses for the Toronto head office and Sudbury exploration office equipment, furniture and fixtures were not significant.

#### *Stock-based compensation*

Stock-based compensation expense was \$0.3 million and \$1.1 million in the fourth quarter and year 2005, respectively, compared to \$0.0 million and \$0.9 million in the quarter and year 2004. In the fourth quarter of 2005, 324,000 stock options were granted while nil were granted in the fourth quarter of 2004. With the growth in FNX's business in 2005 and the addition of personnel, 1,063,000 stock options were granted in 2005 compared to 138,000 in 2004. The stock-based compensation expense was approximately the same this year as last year as a



result of the increase in the time period to vest, and hence the recognition of the expense, for stock options granted in 2005.

#### *Other expenses (income)*

Other expenses (income) resulted in net income of \$2.4 million and \$2.7 million in the fourth quarter and year 2005, respectively, compared to net income of \$0.8 million and \$0.8 million, respectively, in 2004. Other income primarily consists of interest income on cash and term deposits of the Company and shares and warrants received from International Nickel Ventures Corporation (“**INV**”) in December 2005 (see Investments and Related Party Transactions).

#### *Provision for income and resource taxes and provincial capital taxes*

Provision for taxes was \$1.3 million and \$4.7 million in the fourth quarter and year 2005, respectively, compared to \$0.9 million and \$2.5 million, respectively, in 2004. No cash income taxes or resource taxes were payable in either year as the Company continues to have sufficient income and resource tax deductions available to reduce cash taxes to nil. The higher future income and resource tax expense in 2005 is due to higher earnings before taxes and non-controlling interest this year compared to last year and a \$0.7 million one-time, non-cash future tax liability charged to earnings as a result of the disposition of a 50% interest in Aurora as described above.

The Federal Large Corporations Tax, (“**LCT**”) which is a tax based on a corporation’s taxable capital (as defined in the Income Tax Act (Canada)), as at the corporation’s taxation year end. As this capital based tax is creditable against federal income surtaxes and is not a deductible expense for the determination of taxable income, accounting rules require the LCT to be included in the provision for income and resource taxes on the statement of operations. Many provincial jurisdictions, including the Province of Ontario, also charge a tax based on a corporation’s taxable capital. This expense, however, is a deductible expense in the determination of taxable income and is separately disclosed in the statement of operations. As a result of the issuance of 20,500,000 common shares to Dynatec and 7,500,000 common shares under a public offering, both of which occurred in the fourth quarter of 2005, the Company’s taxable capital for both federal LCT and provincial capital taxes increased significantly. Accordingly, FNX accrued in the fourth quarter of 2005, an \$0.8 million LCT expense, which is included in the provision for income and resource taxes, and a \$1.1 million provincial capital tax expense, which is separately disclosed on the statement of operations. Both the LCT and provincial capital taxes were not significant in 2004.

#### *Non-controlling interest*

Non-controlling interest expenses, related to Dynatec’s interest in the SJV, were \$nil and \$4.7 million in the fourth quarter and year 2005, respectively, compared to \$1.1 million and \$4.3 million, respectively, in 2004. As a result of the Dynatec Transaction in October 2005, there will no longer be a non-controlling interest expense for any period subsequent to that date as the SJV was terminated.

#### *Hedging*

FNX does not currently have any commodity or foreign exchange hedging or other derivative instruments and there are currently no plans to enter into any such contracts.



### Adjusted EBITDA

Adjusted earnings before interest, taxes and depreciation and amortization (“Adjusted EBITDA”), a non-GAAP performance measure (please see discussion under non-GAAP Performance Measures below), was \$1.6 million higher than in the fourth quarter of 2004. The Adjusted EBITDA for the year ended December 31, 2005 was \$4.7 million higher than the same period in 2004.

The following table presents the calculation of Adjusted EBITDA for the periods indicated.

|   | <b>Three months ended<br/>December 31</b> |         | <b>Year ended<br/>December 31</b> |          |
|---|---|---------|-----------------------------------|----------|
|   | <b>2005</b>                               | 2004    | <b>2005</b>                       | 2004     |
|   | <b>\$000s</b>                             | \$000s  | <b>\$000s</b>                     | \$000s   |
| Mine operating revenue                  | <b>22,726</b>                             | 16,345  | <b>84,602</b>                     | 60,411   |
| Mine operating expenses <sup>(1)</sup>  | <b>(16,032)</b>                           | (9,641) | <b>(51,484)</b>                   | (35,510) |
| Cash operating margin                   | <b>6,694</b>                              | 6,704   | <b>33,118</b>                     | 24,901   |
| Corporate administration                | <b>(1,744)</b>                            | (686)   | <b>(5,226)</b>                    | (3,398)  |
| Exploration administration              | <b>(856)</b>                              | (642)   | <b>(2,915)</b>                    | (1,970)  |
| Other (expenses) income <sup>(2)</sup>  | <b>819</b>                                | (382)   | <b>995</b>                        | (296)    |
| Non-controlling interest <sup>(3)</sup> | -   | (1,676) | <b>(8,280)</b>                    | (6,225)  |
| Adjusted EBITDA                         | <b>4,913</b>                              | 3,318   | <b>17,692</b>                     | 13,012   |

<sup>(1)</sup> Mine operating expenses exclude mine depreciation and amortization.

<sup>(2)</sup> Excludes interest income and interest expense.

<sup>(3)</sup> Calculated as 25% of cash operating margin, except for the three months ended December 31, 2005.

## Financial Condition and Liquidity

### Cash and cash flows

Cash flow from operating activities totaled \$27.2 million in 2005, respectively, compared to \$13.0 million in 2004. The higher cash flows for the year 2005 were due to the sale of more nickel and copper from the higher quantities of ore sold.

Financing activities resulted in net cash inflows of \$103.8 million for the year, primarily as a result of the issuance of 7.5 million common shares at \$13.60 per common share in November 2005. Options to purchase 0.2 million and 0.9 million common shares were exercised under the Company’s stock option plan in the three months and year periods ended December 31, 2005, respectively, for cash proceeds of \$0.9 million and \$5.0 million, respectively. As a result of the high level of exploration and development activities undertaken during the quarter and year to date 2005, the non-controlling interests’ cash contributions from Dynatec to the SJV exceeded the cash distributions by \$1.9 million for the year 2005.

Investing activities for 2005 resulted in net cash outflows of \$48.9 million for net exploration, development and equipment expenditures that were capitalized as property, plant and equipment, offset somewhat by \$13.8 million of cash as partial consideration for the Dynatec Transaction and the Aurora Transactions.



The net change in cash balances as a result of operating, financing and investing activities was a net cash inflow of \$95.7 million since December 31, 2004. FNX remains debt free and the Company's cash position of \$152.5 million at December 31, 2005, is sufficient to meet all planned cash expenditures in 2006.

#### *Working capital*

Working capital increased \$73.9 million during the fourth quarter of 2005, primarily as a result of the \$98.5 million of net proceeds received on the issuance of 7,500,000 common shares on November 28, 2005, pursuant to a bought deal financing. Working capital also increased \$82.8 million for the year to date, primarily as a result of the above mentioned bought deal and the receipt from Dynatec of \$12.2 million of cash as partial consideration for the sale to Dynatec of a 50% interest in Aurora, partially offset by relatively high levels of cash expenditures on property, plant and equipment in the Sudbury mining district.

#### *Reclamation and other deposits*

Reclamation deposits remained at \$1.2 million throughout the year and include various amounts with government agencies in the Province of Ontario in connection with the McCreedy West, Levack and Podolsky properties. Reclamation deposits are subject to change based upon changes in the underlying mine reclamation and site restoration obligation as a result of updated environmental plans and changes in environmental laws and regulations.

In October 2005, a \$2.4 million deposit was advanced to Dynatec as a deposit for mining contractor services to be provided by Dynatec in connection with the Mining Services Agreement entered into on October 21, 2005 (see note 18(c)). The deposit will ultimately be applied against Dynatec's invoice for December 2007.

#### *Investments*

As a result of the Aurora Transactions and the Dynatec Transaction, FNX owns 7,716,594 million common shares of Dynatec, 13,300,000 million common shares of Lake Shore Gold Corp. and 6,860,715 common shares of Superior Diamonds Inc., all three of which are publically traded corporations. The combined purchase price was \$27.7 million. In addition, FNX holds 3,150,230 common shares and 2,347,886 common share purchase warrants of INV, a recently listed publically traded corporation (see Related Party Transactions and Subsequent Events) with a combined cost base at December 31, 2005 of \$1.7 million. The total market value of these long-term investments as at December 31, 2005 was \$49.1 million.

#### *Property, plant and equipment*

##### *(i) Summary*

Acquisition costs and expenditures on property, plant and equipment totaled approximately \$470.2 million for the year 2005. The cash expenditures consisted of exploration drilling, underground exploration/development, including shaft sinking at Podolsky and shaft rehabilitation at Levack, and the purchase of certain mining equipment. The acquisition expenditures on property, plant and equipment totaled \$423.7 million as a result of \$25.7 million of net property, plant and equipment acquired in the Aurora Transactions in July 2005 and \$398.1 million of property, plant and equipment acquired from the Dynatec Transaction in



October 2005. The following table shows the additions to the respective mineral properties as a result of these two transactions.

**Table 9**

|                   | Dynatec<br>Transaction | Aurora<br>Transactions |
|-------------------|------------------------|------------------------|
|                   | \$000s                 | \$000s                 |
| McCreedy West     | 20,466                 | -                      |
| Aurora properties | 64,480                 | 25,661                 |
| Kirkwood          | 1,200                  | -                      |
| Levack            | 63,203                 | -                      |
| Levack Footwall   | 210,429                | -                      |
| Podolsky          | 35,055                 | -                      |
| Victoria          | 3,250                  | -                      |
|                   | 398,083                | 25,661                 |

The following table shows the net increase (decrease) in property, plant and equipment expenditures for 2005 by property location.

**Table 10**

|                              | Year ended<br>December 31, 2005 | Three months ended<br>December 31, 2005 | Three months ended<br>September 30, 2005 |
|------------------------------|---------------------------------|---|--|
|                              | \$000s                          | \$000s                                  | \$000s                                   |
| Aurora                       | 92,123                          | 76,357                                  | 26,653                                   |
| McCreedy West <sup>(1)</sup> | 31,643                          | 23,714                                  | 3,233                                    |
| Kirkwood                     | 1,400                           | 1,222                                   | 59                                       |
| Levack                       | 73,955                          | 66,250                                  | 2,739                                    |
| Levack Footwall              | 216,574                         | 212,015                                 | 1,725                                    |
| Podolsky                     | 51,311                          | 36,730                                  | 4,031                                    |
| Victoria                     | 3,284                           | 3,266                                   | 12                                       |
|                              | 470,290                         | 419,554                                 | 38,452                                   |
| Corporate                    | (112)                           | (128)                                   | 13                                       |
|                              | 470,178                         | 419,426                                 | 38,465                                   |

<sup>(1)</sup> Pre-production revenue credits from the McCreedy West PM Deposit totaled \$3.6 million.

FNX's total capital expenditure budget on property, plant and equipment for 2006 is \$97 million (including \$12 million for exploration). In 2006, FNX is budgeting \$14 million to acquire equipment and further develop the PM Deposit at the McCreedy West mine. Capital expenditures at Levack in 2006 are budgeted at \$47 million (including exploration on the Levack Footwall Deposit) and will focus on continuing dewatering and shaft rehabilitation, installing ore handling infrastructure and development work to reach future production targets. No bulk samples are currently planned to be extracted from Levack in 2006. Capital expenditures at Podolsky in 2006 are budgeted at \$28 million and will involve further shaft sinking to reach the final planned depth of 2,650 feet, installation of ore handling infrastructure, development into the 2000 Deposit to extract a bulk sample in early 2007 and the construction of certain environmental and other surface infrastructures including a water treatment plant. Capitalized exploration expenditures on the rest of FNX's properties, including the Aurora properties, is budgeted at approximately \$5 million in 2006. The Company has sufficient cash resources on



hand and will generate additional cash flow from operating activities to fund its capital expenditure program in 2006.

*(iii) Sudbury Basin properties option agreement*

On November 29, 2001, FNX entered into a definitive agreement (the "**Option to Purchase Agreement**") with Inco to acquire a 100% interest in the mineral rights to five Inco mineral properties located in the Sudbury Basin, Ontario (Kirkwood, Levack, McCreedy West, Podolsky and Victoria, collectively, the "**Properties**"), and the right to use such part of the surface rights and on-site facilities as are required to permit exploration, development and mining operations to be conducted on the Properties. The Option to Purchase Agreement became effective January 10, 2002 (the "**Effective Date**"). FNX entered into an agreement (the "**SJV Agreement**") with Dynatec, which also became effective on the Effective Date, pursuant to which Dynatec acquired 25% of FNX's interest, rights and obligations in the Option to Purchase Agreement. Accordingly, on the Effective Date, FNX and Dynatec formed a joint venture known as the SJV, with FNX holding a 75% interest and Dynatec a 25% interest. FNX managed exploration activities relating to the SJV and Dynatec managed mining operations. The option to acquire the Properties was exercised by FNX and Dynatec on December 1, 2003.

On October 21, 2005, FNX acquired Dynatec's 25% interest in the Properties and the SJV (which was terminated) pursuant to the Dynatec Transaction (see note 18(c)). Accordingly, FNX now holds a 100% interest in the Properties.

The Option to Purchase Agreement includes the following additional terms:

- If FNX discovers a New Deposit (as defined in the Option to Purchase Agreement) on any of the Properties and elects to complete a bankable feasibility study on such New Deposit recommending production, and should such New Deposit contain mineral resources having a value (based on then current metal prices) of at least 600 million pounds of nickel equivalent at the time of such bankable feasibility study, Inco has a right to re-acquire a 51% interest in such a New Deposit but not the Properties (the "**Back-in Right**") by bringing the New Deposit into commercial production without financial recourse to FNX. Until Inco achieves payback, it shall receive 80% of net revenues from production from the New Deposit. If Inco re-acquires a 51% interest in a New Deposit, Inco and FNX will form a joint venture, with Inco as the operator, to hold and operate the New Deposit.
- Inco continues to be responsible for all environmental liabilities existing on the Properties at the Effective Date. The Company is now responsible for all environmental liabilities incurred on the Properties that result from the actions taken after the Effective Date. Processing environmental obligations cease upon delivery of ore to Inco.
- Inco has a right of first offer to purchase any interest in the Properties that the SJV proposes to sell to an arm's-length third party but does not apply to the transfer of interest in the Properties between FNX and Dynatec.

On the Effective Date, the Corporation and Inco agreed to a form of off-take agreement (the "**Off-take Agreement**"), which forms the basis of separate Off-take Agreements to be entered into with Inco upon the commencement of mining of any deposits found on the Properties. Under each Off-take Agreement Inco is granted the right to purchase all ores produced on the Properties for recovered accountable metals derived from the Properties, less applicable milling,

smelting and refining charges. Inco also has the right to refuse to purchase any ores that are unsuitable for treatment or if Inco does not have sufficient processing capacity to handle such ores, in which case, FNX is entitled to have such ores processed by a third party whereby Inco will be entitled to be paid a 2% net smelter royalty for nickel, copper and cobalt and a net smelter royalty ranging from 2.5% to 5% for precious and platinum group metals. Inco has agreed to concentrate, smelt and refine all of FNX's ore produced through to December 31, 2007.

Much of Inco's labour force in Sudbury is unionized and the term of the collective agreement ends May 31, 2006. In 2003, a strike at Inco's operations in Sudbury resulted in Inco declaring force majeure for the three month period until the strike was resolved. FNX was unable to ship ore to Inco during that period of time. Should a similar situation occur, shipments of ore would be adversely affected. Management is looking into alternatives to mitigate this situation should it arise.

*(iii) McCreedy West*

Commercial production from the Inter Main deposit at the McCreedy West mine was achieved on November 1, 2003 and the scheduled mining rate of 1,000 tons per day was reached in April 2004. Commencing May 2005, revenue and expenses from ore mined and shipped from the McCreedy West PM Deposit have been included in the statement of operations. The \$14.9 million of accumulated mineral property and exploration capital costs to date, net of \$3.6 million of pre-production revenue credits, were transferred from mineral exploration properties to McCreedy West mining property and development (\$13.6 million) and plant and equipment (\$1.3 million). As at December 31, 2005, FNX held a 100% interest in McCreedy West.

*(iv) Exploration*

The carrying value of the mineral exploration properties represents the accumulated costs to date for the acquisition of and exploration costs incurred by FNX on its non-producing mineral exploration properties (see Note 18). Mineral exploration properties are not being amortized. FNX's active mineral exploration properties are located in the Sudbury mining district, and are comprised as follows:

| <b>Table 11</b>          | <b>2005</b>    | 2004   |
|--------------------------|----------------|--------|
|                          | <b>\$000s</b>  | \$000s |
| Aurora properties        | <b>92,123</b>  | -      |
| Kirkwood                 | <b>1,600</b>   | 200    |
| Levack                   | <b>81,509</b>  | 7,554  |
| Levack Footwall          | <b>219,188</b> | 2,614  |
| McCreedy West PM Deposit | -              | 13,472 |
| Podolsky                 | <b>69,396</b>  | 18,085 |
| Victoria                 | <b>6,175</b>   | 2,891  |
|                          | <b>469,991</b> | 44,816 |

As at December 31, 2005, FNX held a 100% interest in the Kirkwood, Levack (including the Levack Footwall), Podolsky and Victoria mineral properties, all of which are located in the Sudbury Basin region of Ontario.

The Aurora properties are located in the Sudbury Basin region, Timmins, and in north-western Ontario and the Temiscamingue region of Quebec. All of Aurora's properties are in the exploration stage and there can be no assurance that commercially viable mineral deposits or reserves exist on them. The most material mineral properties that are included in the Aurora properties are located in the Sudbury Basin region and are pursuant to a joint venture agreement (the "**Falconbridge Joint Venture**") with Falconbridge Limited ("**Falconbridge**"). As at December 31, 2005, the Company and Falconbridge held a 70% and 30% interest, respectively, in the Falconbridge Joint Venture. The Company is the operator of the Falconbridge Joint Venture. FNX holds between 50% and 100% interests in the remaining mineral exploration properties included in the Aurora properties.

During the fourth quarter, FNX drilled 86,541 feet of diamond drilling in 127 holes. The following table details the drilling by property.

**Table 12**

|                            | Three months ended<br>December 31, 2005 |               | Year ended<br>December 31, 2005 |                |
|----------------------------|---|---------------|---------------------------------|----------------|
|                            | # Holes                                 | # Feet        | # Holes                         | # Feet         |
| Aurora                     | 16                                      | 37,478        | 16                              | 37,478         |
| Kirkwood                   | 0                                       | 0             | 5                               | 2,139          |
| Levack                     | 0                                       | 0             | 3                               | 4,746          |
| McCreedy West – Phase 1    | 79                                      | 12,364        | 258                             | 59,206         |
| McCreedy West – PM Deposit | 12                                      | 1,705         | 154                             | 45,193         |
| McCreedy West – Other      | 1                                       | 1,237         | 5                               | 13,406         |
| Levack Footwall            | 18                                      | 30,555        | 51                              | 119,025        |
| Podolsky                   | 1                                       | 3,202         | 21                              | 15,595         |
| Victoria                   | 0                                       | 0             | 0                               | 0              |
|                            | <u>127</u>                              | <u>86,541</u> | <u>513</u>                      | <u>296,788</u> |

The drilling at McCreedy West during the fourth quarter of 2005 was a continuation of delineation and definition drilling in the Inter Main, East Main and PM Deposits, primarily from underground together with one surface drill hole to test for extensions of the Inter Main towards the southwest. The long drill hole started at Podolsky in the third quarter to test the areas within the offset under both the North and 2000 deposits was completed. Drilling that had previously been scheduled to recommence at Levack from suitable platforms in the underground workings was deferred later in to 2006 pending access.

The main focus of drilling remains the Levack Footwall Deposit and, as reported in a press release subsequent to the end of the quarter, results continue to be very positive and confirm the grade and potential of this deposit. Twelve of the 18 holes completed in the quarter have been from underground platforms within Falconbridge's Craig mine.

The 2005 drilling program on the Aurora properties, initiated by FNX since July 1, 2005, was completed during the fourth quarter. Three of these holes were on the past producing Falconbridge Mine property with the remaining 13 holes being on the Foy-Bowell property, both of which are located in the Sudbury Basin.

*Mine closure and site restoration*

FNX estimates the total future mine closure and site reclamation costs (also known as asset retirement obligations) associated with the Sudbury operations to be \$1.6 million, unchanged



from 2004. These estimates are formally reviewed by technical personnel every year or more frequently if required by regulatory agencies. A credit adjusted risk free rate of 6.0% has been utilized to determine the mine closure and site restoration obligation recorded in the consolidated balance sheets. Management anticipates that such obligations will substantially be settled at or near the closure of its mining operations.

The cost estimates of mine closure and site restoration obligations are based on reclamation standards that meet current regulatory requirements. In view of the uncertainties concerning environmental remediation, the ultimate cost of the mine closure and site restoration obligations could differ materially from the estimated amounts provided. The estimate of the total liability for mine closure and site restoration costs is subject to change based upon amendments to laws and regulations and as new information concerning the Company's operations becomes available. Future changes, if any, to the estimated total liability as a result of amended regulations, laws and operating assumptions may be significant and would be recognized prospectively as a change in accounting estimate when applicable. Environmental laws are continually evolving and FNX is not able to determine the impact, if any, of environmental laws and regulations that may be enacted in the future on its results of operations or financial position due to the uncertainty surrounding the ultimate form that such future laws and regulations may take.

#### *Non-controlling interest*

Net cash payments from non-controlling interest totaled \$nil million and \$15.3 million, respectively, in the fourth quarter and year 2005, compared to net cash payments to Dynatec of \$nil million and \$12.7 million, respectively, in 2004. Cash expenditures by the SJV for property, plant and equipment exceeded the cash flow generated by the SJV's mining operations in 2005 as a result of increased levels of spending on property, plant and equipment compared to 2004. The non-controlling interest was eliminated in October 2005 as a result of the Dynatec Transaction.

#### *Share capital*

On November 28, 2005, FNX issued 7,500,000 common shares under a bought deal financing at \$13.60 per common share, generating \$102.0 million of gross proceeds and, after deducting \$5.1 million of share issue expenses and recognizing a future income tax asset of \$1.6 million associated with those share issue costs, resulted in net credit to share capital of \$98.5 million. FNX entered into this financing in order to facilitate its aggressive capital expenditure program in 2006 to advance development of its existing and future mining properties.

As at December 31, 2005, FNX had 83.5 million common shares issued and outstanding an increase of 28.2 million shares from September 30, 2005, primarily as a result of the issuance of 20.5 million shares, with an ascribed value of \$285.0 million, for the Dynatec Transaction and the 7.5 million shares for the bought deal financing.

As at December 31, 2005, stock options to purchase 2.6 million common shares at a weighted average price of \$7.02 per share were outstanding. From December 31, 2005 to March 30, 2006, 25,000 stock options have been granted, and as of March 30, 2005, an additional 159,500 stock options were exercised for cash proceeds of \$0.6 million. The number of common shares issued and outstanding as at March 30, 2006 totals 83.7 million. The number of stock options outstanding at March 30, 2006 represents 2.9% of the issued and outstanding common shares at that time.



For the year 2005, share capital has increased by \$432.5 million from \$126.4 million to \$558.9 million as a result of the \$334.7 million ascribed to the shares issued pursuant to the Aurora Transactions and the Dynatec Transaction, plus \$98.5 million for the bought deal financing, plus \$5.0 million upon the exercise of 993,000 stock options, less \$8.5 million to recognize a future tax liability associated with the renunciation of \$20.6 million of Canadian Exploration Expenses ("CEE") to flow-through common shareholders. An interest expense of \$0.1 million was charged to other expenses for the year to date as required under the Income Tax Act (Canada) for prescribed interest related to unexpended flow-through share balances. All \$20.6 million of flow-through funds were expended on CEE in 2005.

Effective July 1, 2005, FNX implemented a deferred share units plan (the "DSU Plan") for Directors to promote a greater alignment of interests between shareholders and Directors by potentially linking a portion of Director compensation to the future value of FNX's common shares. Directors have the choice to receive, in increments of 25%, up to 100% of their compensation in the form of deferred share units rather than by way of cash. Included in stock-based compensation expense is \$28,000 related to 1,974 common shares that were earned in 2005 and are reserved for issuance under the DSU Plan.

#### *Post-retirement benefits*

FNX does not currently have any post-retirement benefit plans for its employees, officers and directors. The Company does, however, match contributions made by employees and officers to their registered retirement savings plans to a maximum of the lesser of 5% of salary and the maximum permitted by regulation.

#### **Reserves and Resources**

During the current reporting period updated resource estimations for the McCreedy West Inter Main, 700 Footwall and Levack 1300 deposits were compiled to reflect current geological interpretations and additional diamond drilling. Production is currently from the nickel-contact deposits (Inter Main and East Main), the 700 Footwall Deposit and the PM Footwall Deposit. Stope access and associated underground mapping have significantly enhanced our understanding of the McCreedy West contact environment and the geological controls on the mineralization.

Resources are converted to reserves where they meet or exceed economic parameters of metal price, off-take, and mining cost after applying appropriate mine planning and dilution associated with the mining methods. Reflecting the significant increase in metal prices changes, have been made in the prices used to convert resources to reserves. As reserves will be mined in the near term, metal prices have been adjusted upwards. The price assumptions for resource estimates remain the same as those previously used in 2004.

McCreedy West

**Table 13 - Summary of reserves at McCreedy West**

| <u>Category</u> | <u>Deposit Type</u>     | <u>Tons</u><br>millions | <u>Ni</u><br>% | <u>Cu</u> | <u>Pt</u> | <u>Pd</u><br>(oz/ton) | <u>Au</u> | <u>TPM</u> |
|-----------------|-------------------------|-------------------------|----------------|-----------|-----------|-----------------------|-----------|------------|
| Probable        | Contact Deposits        | 1.21                    | 1.65           | 0.19      |           |                       |           |            |
|                 | Footwall Deposits - 700 | 0.12                    | 0.69           | 6.04      | 0.04      | 0.07                  | 0.04      | 0.15       |
|                 | Footwall Deposits - PM  | 0.66                    | 0.27           | 1.03      | 0.06      | 0.07                  | 0.02      | 0.16       |
|                 |                         | <u>1.99</u>             |                |           |           |                       |           |            |

Notes to Reserves Table:

- All reserve estimates are based on estimates of long-term metal prices in US\$: Cu=\$1.50/lb., Ni=\$5.00/lb., Pt=\$800/oz., Pd=\$250/oz., Au=\$400/oz. and a Canadian dollar exchange rate of \$1/US\$0.85.
- Reserves are the mineable economic portion of the resources. Contact Deposit reserve estimates include mining dilution at grades assumed to be zero, as noted in the text above, and include mining recovery of about 85%. Mining cut-off for reserves was determined from net smelter return (NSR) based on the Inco Off-take Agreement metal accountability and feasibility study estimated mining costs. Ni equivalent cut-off grades range from 1% to 1.4% depending on mining method.
- The 700 Deposit reserve estimate is based on the fully diluted resources and used the same NSR-mining cut-off approach as for the contact deposits, which approximates a cut-off grade of 1.4% Ni equivalent, with a recovery of 85%.
- PM Deposit reserves are based on pre-feasibility metal prices of US\$: Cu=\$1.50/lb., Ni=\$5.00/lb., Pt=\$800/oz., Pd=\$250/oz., Au=\$400/oz., a Canadian dollar exchange rate of \$1/US\$0.85, a \$36 NSR cut-off based on the Inco Off-take Agreement metal accountability and a 68% mining recovery.
- TPM = Pt+Pd+Au

**Table 14 - Summary of resources at McCreedy West**

| <u>Category</u> | <u>Deposit Type</u> | <u>Tons</u><br>millions | <u>Ni</u><br>% | <u>Cu</u> | <u>Pt</u> | <u>Pd</u><br>oz/ton | <u>Au</u> | <u>TPM</u> |
|-----------------|---------------------|-------------------------|----------------|-----------|-----------|---------------------|-----------|------------|
| Indicated       | Contact             | 1.15                    | 2.04           | 0.27      | -         | -                   | -         | -          |
|                 | Footwall - 700      | 0.15                    | 0.65           | 5.94      | 0.04      | 0.08                | 0.04      | 0.16       |
|                 | Footwall - PM       | 2.66                    | 0.26           | 1.17      | 0.07      | 0.08                | 0.02      | 0.17       |
|                 |                     | <u>3.96</u>             |                |           |           |                     |           |            |
| Inferred        | Contact             | 0.37                    | 1.63           | 0.33      |           |                     |           |            |
|                 | Footwall - 700      | 0.01                    | 0.78           | 6.01      | 0.07      | 0.11                | 0.06      | 0.24       |
|                 | Footwall - PM       | 1.10                    | 0.28           | 1.11      | 0.08      | 0.11                | 0.02      | 0.21       |
|                 |                     | <u>1.48</u>             |                |           |           |                     |           |            |

Notes to Resources Table:

- The indicated mineral resources are inclusive of those mineral resources modified to produce the mineral reserves.
- Contact Deposit resource estimates are based on 1% Ni cut-off grade and a minimum 8 ft.

true width.

- The 700 Deposit resource estimate is based on 1.4% Ni equivalent cut-off grade and a minimum true mining width of 6 ft. or 7 ft., depending on vein dip. The indicated resource are those blocks above \$77/ton NSR as based on the 700 Deposit Inco Off-take Agreement metal accountability.
- The PM deposit resource estimate is based on a 0.058 oz/ton TPM cut-off.
- The Upper PM (950) resource volume is based on a 0.75% Ni equivalent cut-off grade and a minimum eight ft true width. Nickel equivalency is based on estimates of long-term metal prices of (\$US): Cu=\$0.70/lb., Ni=\$3.50/lb., Pt=\$600/oz., Pd=\$250/oz., Au=\$340/oz. and a Canadian dollar exchange rate of \$1/US\$0.67. The indicated resources are those blocks above \$87/ton NSR as based on the 700 Deposit Inco Off-Take Agreement metal accountability.
- The 700 Deposit resource estimate includes internal and external mining and sill dilution. Estimates for the Contact Deposits and the PM and Upper PM(950) Deposits include internal dilution.
- TPM = Pt+Pd+Au

## Contractual Obligations and Commitments

The following table presents FNX's contractual obligations as at December 31, 2005.

| <b>Table 15</b>                 | <b>Total</b>         | 2006         | 2007-9       | 2010-11  | >2012        |
|---------------------------------|----------------------|--------------|--------------|----------|--------------|
|                                 | <b>\$000s</b>        | \$000s       | \$000s       | \$000s   | \$000s       |
| Operating leases                | <b>800</b>           | 200          | 600          | -        | -            |
| Deferred payment <sup>(1)</sup> | <b>15,000</b>        | 7,500        | 7,500        | -        | -            |
| Mine closure & restoration      | <b>1,600</b>         | -            | -            | -        | 1,600        |
|                                 | <b><u>17,400</u></b> | <u>7,700</u> | <u>8,100</u> | <u>-</u> | <u>1,600</u> |

<sup>(1)</sup> The deferred payment obligation is described in the Dynatec Transaction.

## Related Party Transactions

In 2004, FNX invested \$0.2 million of funds in INV, which at that time was a private mineral prospecting company. The President and Chief Executive Officer (who is a director of FNX and a director of INV), two other directors and two senior officers of FNX also invested in INV in 2004. In 2005, FNX invested a further \$0.6 million of funds in INV, resulting in FNX holding 920,230 common shares of INV. In December 2005, as part of a planned Initial Public Offering by INV, FNX was issued 500,000 common shares for cash consideration of \$0.3 million and an additional 900,000 common shares with an ascribed value of \$0.4 million in payment of past administrative services and financial support provided by FNX to INV from November 2003 to December 2005. Also in December 2005, FNX was issued common share purchase warrants, with an ascribed value of \$0.7 million) in exchange for FNX foregoing its right of first option to acquire any property interest of INV. Each of the 2,347,886 share purchase warrants entitles the holder to acquire one common share of INV at a price of \$1.40 until December 7, 2010. Subsequent to year end FNX purchased an additional 830,000 common shares of INV for cash consideration of \$1.0 million.



Under the terms of an agreement between FNX and INV, dated January 1, 2006, FNX has agreed to provide certain administrative services and facilities to INV for a fee of \$10,000 per month commencing January 1, 2006. These services include providing office facilities and communication equipment in addition to the non-exclusive services of certain FNX personnel (limited to 20% each per week), including the Vice President and Chief Financial Officer of FNX, who serves as the Vice President and Chief Financial Officer of INV, and accounting and administrative personnel as required by the Vice President and Chief Financial Officer of INV. In addition to the \$10,000 monthly fee, the Corporation will reimburse FNX for the non-exclusive services of the Vice President Business Development of FNX, who serves as the President and Chief Executive Officer of INV, and the Investor Relations Officer of FNX, who is also the Director of Investor Relations for INV. Such reimbursement shall be calculated as an amount equal to the salaries and benefits paid to such individuals, multiplied by the percentage of their respective time spent providing services to INV.

On March 17, 2006, INV completed an Initial Public Offering (“IPO”) of 18,500,000 common shares at a price of \$1.20 per common share and was listed on the Toronto Stock Exchange. As part of the IPO, FNX purchased 830,000 common shares of INV for cash consideration of \$996. As at March 24, 2006, FNX owned 3,150,230 common shares of INV, representing 9.9% of the issued and outstanding common shares of INV, and 2,347,886 share purchase warrants at an exercise price of \$1.40 per common share.

### **Non-GAAP Performance Measures**

Cash operating margin per ton of ore sold, cash operating cost per pound of nickel sold, Adjusted Earnings and Adjusted EBITDA are included in this MD&A because these statistics are key performance measures that management uses to monitor performance. Management uses these statistics to assess how well the Company is performing compared to plan and to assess the overall effectiveness and efficiency of mining operations. Management believes that the inclusion of these statistics in the MD&A helps an investor to assess performance “through the eyes of management” and that certain investors use these statistics to assess the Company’s performance. These performance measures do not have a meaning within GAAP and, therefore, amounts presented may not be comparable to similar data presented by other mining companies. The data is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses. Management evaluates the estimates periodically including those considered to be critical: mineral reserve and resource determinations; impairment; future income and resource taxes; and mine closure and site restoration obligations. Actual results may differ from these estimates by material amounts.

#### *Mineral reserves and mineral resources*

Mineral reserves and resources are estimated to determine future recoverable mine production based on assessment of geological, engineering and metallurgical analyses, estimates of future production costs, capital costs, mine closure and site restoration costs as well as metal prices



and foreign exchange rates. The costs of mineral properties are capitalized and amortized by the unit-of-production basis based on related proven and probable mineral reserves.

#### *Impairment*

The carrying value of FNX's operating mines and mineral properties is periodically reviewed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable. If total estimated future cash flows on an undiscounted basis from an operating mine is less than the carrying amount of the asset, an impairment loss is measured and recorded to write down the asset to its fair value.

#### *Future income and resource tax liabilities*

FNX uses the liability method of tax allocation for accounting for income and resource taxes. Under the liability method, future tax assets and liabilities are determined on differences between the financial reporting and tax bases of assets and liabilities. Future income and resource tax assets and liabilities are measured using enacted or substantially enacted tax rates expected to be in effect in the years in which those temporary differences are expected to be recovered or settled.

#### *Mine closure and site restoration obligations*

Mine closure and site restoration obligations (also known as asset retirement obligations) are estimated based on environmental plans in compliance with current environmental and regulatory requirements. Mine closure and site restoration costs are estimated and provided for along with an identical asset, when the Company makes any physical changes to the environment at one of its mineral properties and the liability can be reasonably estimated. The asset is amortized on a unit-of-production basis over the life of the mine. The accrued obligation is increased by an annual interest component such that at the end of the asset's life the provision is equal to the balance estimated to be paid at that time. In view of the uncertainties regarding these future obligations, the ultimate timing and cost of mine closure and site restoration may differ materially from these estimates.

### **Recent Accounting Pronouncements**

In January, the Canadian Institute of Chartered Accountants ("**CICA**") issued Section 1530 of the CICA Handbook, "Comprehensive Income", Section 3251, "Equity", Section 3855, "Financial Instruments – Recognition and Measurement" and Section 3865, "Hedges". The following new standards increase harmonization with US GAAP and will require the following:

1. Financial assets will be classified as either held-to-maturity, held-for-trading or available-for-sale. Held-to-maturity classification will be restricted to fixed maturity instruments that the Company intends and is able to hold to maturity and will be accounted for at amortized costs. Held-for-trading instruments will be recorded at fair value with realized and unrealized gains and losses reported in net earnings. The remaining financial assets will be classified as available-for-sale and will be recorded at fair value with unrealized gains and losses reported in a new category of the consolidated statement of financial position under shareholders' equity called other comprehensive income ("**OCI**").
2. Derivatives will be classified as held-for-trading unless designated as hedging instruments. All derivatives, including embedded derivatives that must be separately accounted for, will be recorded at fair value on the consolidated statement of financial

position. For derivatives that hedge the changes in fair value of an asset or liability, changes in the derivatives' fair value will be reported in net earnings and be substantially offset by changes in the fair value if the hedged asset or liability attributable to the risk being hedged. For derivatives that hedge variability in cash flows, the effective portion of the changes in the derivatives' fair value will be initially recognized as OCI and the ineffective portion will be recorded in net earnings. The amounts temporarily recorded in OCI will subsequently be reclassified to net earnings in the periods when net income is affected by the variability in the cash flows of the hedged item.

The above guidance will apply for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Earlier adoption will be permitted only as of the beginning of a fiscal year. The impact of implementing these new standards is not yet determinable as it is highly dependent on the fair values, outstanding positions and hedging strategies at the time of adoption.

In November 2005, the Emerging Issues Committee ("EIC") of the CICA issued Abstract Number 159, "Conditional Asset Retirement Obligations", to clarify the accounting treatment for a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. Under the EIC, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The guidance is effective for the second quarter of 2006 and is to be applied retroactively, with restatement of prior periods. The implementation of this EIC is not expected to have a material impact on the Company's consolidated financial statements.

### Summary of Selected Quarterly Financial Information

| <b>Table 16</b>           | <u>Q1</u>     | <u>Q2</u>     | <u>Q3</u>       | <u>Q4</u>     | <u>Total</u>  |
|---------------------------|---------------|---------------|-----------------|---------------|---------------|
|                           | \$000s        | \$000s        | \$000s          | \$000s        | \$000s        |
| <b>2005</b>               |               |               |                 |               |               |
| Revenue                   | <b>19,057</b> | <b>24,231</b> | <b>18,588</b>   | <b>22,726</b> | <b>84,602</b> |
| Net earnings (loss)       | <b>2,484</b>  | <b>3,855</b>  | <b>(2,218)</b>  | <b>477</b>    | <b>4,597</b>  |
| Basic and diluted EPS     | <b>\$0.05</b> | <b>\$0.08</b> | <b>(\$0.04)</b> | <b>\$0.01</b> | <b>\$0.08</b> |
| <b>2004</b>               |               |               |                 |               |               |
| Revenue                   | 12,007        | 16,738        | 15,321          | 16,345        | 60,411        |
| Net earnings              | 1,778         | 1,048         | 842             | 2,328         | 5,997         |
| Basic and diluted EPS     | \$0.04        | \$0.02        | \$0.02          | \$0.05        | \$0.12        |
| <b>2003<sup>(1)</sup></b> |               |               |                 |               |               |
| Revenue                   | -             | -             | -               | 6,321         | 6,321         |
| Net earnings (loss)       | (1,560)       | (1,487)       | (3,010)         | (2,249)       | (8,306)       |
| Basic and diluted EPS     | (\$0.05)      | (\$0.03)      | (\$0.08)        | (\$0.05)      | (\$0.17)      |

(1) The first year of commercial production for the Company.

FNX declared commercial production at its first mine, McCreedy West, on November 1, 2003, thereby making comparisons to prior periods somewhat difficult. The quarterly trend since November 2003 has generally been towards increasing revenues (subject to metal price fluctuations) and net earnings as a result of higher levels of ore mined and the resultant metal sales. With the inclusion of ore mined from the PM Deposit the Company's revenues should continue to increase.

**Table 17 Quarterly Metal Production and Sales Statistics**

| <b>2005</b>                          | <b>Q1</b>     | <b>Q2</b>      | <b>Q3</b>      | <b>Q4</b>      |
|--------------------------------------|---------------|----------------|----------------|----------------|
| <b>Ore (tons)</b>                    |               |                |                |                |
| Mined                                | 847,467       | 109,479        | 124,169        | 124,751        |
| Pre-production ore                   | 15,875        | 6,118          | -              | -              |
| <b>Sold</b>                          |               |                |                |                |
| Nickel ore                           | 78,915        | 78,762         | 74,616         | 84,358         |
| Copper ore                           | 4,421         | 22,070         | 37,179         | 47,046         |
| <b>Total ore</b>                     | <b>83,336</b> | <b>110,832</b> | <b>111,795</b> | <b>131,404</b> |
| <b>Grade of ore sold</b>             |               |                |                |                |
| Nickel ore (%Ni)                     | 1.7           | 1.7            | 1.9            | 1.6            |
| Copper ore (%Cu)                     | 9.6           | 3.6            | 1.8            | 2.1            |
| <b>Payable metal sold (000s lbs)</b> |               |                |                |                |
| Nickel                               | 1,798         | 2,271          | 1,798          | 2,151          |
| Non-controlling interest             | (450)         | (568)          | (450)          | -              |
| <b>Net to FNX</b>                    | <b>1,348</b>  | <b>1,703</b>   | <b>1,348</b>   | <b>2,151</b>   |
| <b>Copper</b>                        |               |                |                |                |
| Non-controlling interest             | (274)         | (430)          | (336)          | -              |
| <b>Net to FNX</b>                    | <b>821</b>    | <b>1,289</b>   | <b>1,008</b>   | <b>2,053</b>   |
| <b>Metal sales revenue</b>           |               |                |                |                |
| Average Ni price (US\$/lb)           | 7.46          | 6.83           | 6.28           | 5.77           |
| Average Cu price (US\$/lb)           | 1.48          | 1.45           | 1.73           | 2.07           |
| \$/US\$ exchange rate                | 1.23          | 1.49           | 1.20           | 1.17           |
| <b>Total revenue (\$000s)</b>        | <b>19,057</b> | <b>24,231</b>  | <b>18,588</b>  | <b>22,726</b>  |
| <b>Revenue (\$/ton of ore sold)</b>  | <b>228</b>    | <b>219</b>     | <b>166</b>     | <b>173</b>     |
| <b>Cash cost of metals sold</b>      |               |                |                |                |
| Mining (\$000s)                      | 10,564        | 12,634         | 12,254         | 16,032         |
| Cash cost (US\$/lb of Ni sold)       | 3.61          | 2.73           | 3.35           | 3.11           |
| Cash cost (\$/ton of ore sold)       | 127           | 114            | 110            | 122            |

- Notes:
1. All production figures are shown on a 100% basis with Dynatec's 25% interest shown as non-controlling interest.
  2. Mined relates to ore that was mined from McCreedy West and brought to surface during the period.
  3. Tons of ore, grade and payable metal sold relate to ore that was mined from McCreedy West, and shipped to Inco and was, accordingly, recognized in revenue during the period.
  4. Cash operating cost per pound of nickel sold excludes mine depreciation and amortization and includes mining, milling, smelting, refining, haulage and marketing costs and is net of by-product credits.
  5. Copper grades reflect a blend of lower grade PM Deposit ore with higher grade ores from other zones.

**Table 18 Quarterly Metal Production and Sales Statistics**

| <b>2004</b>                    | <b>Q1</b> | <b>Q2</b> | <b>Q3</b> | <b>Q4</b> |
|--------------------------------|-----------|-----------|-----------|-----------|
| Ore (tons)                     |           |           |           |           |
| Mined                          | 57,821    | 89,259    | 75,504    | 82,213    |
| Pre-production ore             | -         | 3,930     | 4,717     |           |
| Sold                           |           |           |           |           |
| Nickel ore                     | 55,484    | 82,481    | 75,075    | 78,740    |
| Copper ore                     | 2,377     | 2,953     | 6,106     | 3,552     |
| Total ore                      | 57,861    | 85,434    | 81,181    | 82,292    |
| Grade of ore sold              |           |           |           |           |
| Nickel ore (%Ni)               | 1.6       | 1.7       | 1.5       | 1.7       |
| Copper ore (%Cu)               | 5.7       | 6.2       | 5.9       | 5.1       |
| Payable metal sold (000s lbs)  |           |           |           |           |
| Nickel                         | 1,224     | 1,940     | 1,580     | 1,843     |
| Non-controlling interest       | (306)     | (485)     | (395)     | (461)     |
| Net to FNX                     | 918       | 1,455     | 1,185     | 1,382     |
| Copper                         | 448       | 617       | 940       | 638       |
| Non-controlling interest       | (112)     | (154)     | (235)     | (160)     |
| Net to FNX                     | 336       | 463       | 705       | 478       |
| Metal sales revenue            |           |           |           |           |
| Average Ni price (US\$/lb)     | 6.44      | 5.65      | 6.33      | 6.53      |
| Average Cu price (US\$/lb)     | 1.52      | 1.14      | 1.30      | 1.45      |
| \$/US\$ exchange rate          | 1.32      | 1.36      | 1.31      | 1.22      |
| Total revenue (\$000s)         | 12,007    | 16,738    | 15,321    | 16,345    |
| Revenue (\$/ton of ore sold)   | 207       | 196       | 189       | 199       |
| Cash cost of metals sold       |           |           |           |           |
| Mining (\$000s)                | 6,552     | 10,081    | 9,236     | 9,641     |
| Cash cost (US\$/lb of Ni sold) | 3.06      | 3.13      | 3.35      | 3.54      |
| Cash cost (\$/ton of ore sold) | 113       | 118       | 114       | 117       |

- Notes:
1. All production figures are shown on a 100% basis with Dynatec's 25% interest shown as non-controlling interest.
  2. Mined relates to ore that was mined from McCreedy West and brought to surface during the period.
  3. Tons of ore, grade and payable metal sold relate to ore that was mined from McCreedy West, and shipped to Inco and was, accordingly, recognized in revenue during the period.
  4. Cash operating cost per pound of nickel sold excludes mine depreciation and amortization and includes mining, milling, smelting, refining, haulage and marketing costs and is net of by-product credits.
  5. Copper grades reflect a blend of lower grade PM Deposit ore with higher grade ores from other zones.



**Table 19 Consolidated Quarterly Statements of Operations (unaudited)**

| <b>2005</b>                      | Q1      | Q2      | Q3      | Q4      | Total   |
|----------------------------------|---------|---------|---------|---------|---------|
|                                  | \$000s  | \$000s  | \$000s  | \$000s  | \$000s  |
| <b>Mine operating revenues</b>   | 19,057  | 24,231  | 18,588  | 22,726  | 84,602  |
| <b>Mine operating expenses</b>   |         |         |         |         |         |
| Mining                           | 10,564  | 12,634  | 12,254  | 16,032  | 51,484  |
| Depreciation and amortization    | 1,605   | 1,828   | 2,130   | 3,205   | 8,768   |
|                                  | 12,169  | 14,462  | 14,384  | 19,237  | 60,257  |
| <b>Expenses</b>                  |         |         |         |         |         |
| Corporate administration         | 1,069   | 1,497   | 916     | 1,744   | 5,226   |
| Exploration administration       | 855     | 708     | 496     | 856     | 2,915   |
| Capital taxes                    | -       | -       | -       | 1,135   | 1,135   |
| Stock-based compensation         | 102     | 259     | 365     | 342     | 1,068   |
| Depreciation                     | 17      | 16      | 25      | 31      | 89      |
| Loss on disposition of Aurora    | -       | -       | 2,600   | -       | 2,600   |
| Other expenses (income)          | (37)    | (227)   | (65)    | (2,410) | (2,739) |
|                                  | 4,882   | 7,516   | (133)   | 1,791   | 14,056  |
| Income and resource taxes        | (865)   | (1,375) | (1,166) | (1,314) | (4,721) |
| Non-controlling interest         | (1,533) | (2,286) | (919)   | -       | (4,738) |
| <b>Net earnings (loss)</b>       | 2,484   | 3,855   | (2,218) | 477     | 4,597   |
| <b>Earnings (loss) per share</b> | \$0.05  | \$0.08  | (0.04)  | \$0.01  | \$0.08  |

  

| <b>2004</b>                    | Q1     | Q2      | Q3     | Q4      | Total   |
|--------------------------------|--------|---------|--------|---------|---------|
|                                | \$000s | \$000s  | \$000s | \$000s  | \$000s  |
| <b>Mine operating revenues</b> | 12,007 | 16,738  | 15,321 | 16,345  | 60,411  |
| <b>Mine operating expenses</b> |        |         |        |         |         |
| Mining                         | 6,552  | 10,081  | 9,236  | 9,641   | 35,510  |
| Depreciation and amortization  | 1,190  | 1,654   | 1,769  | 1,802   | 6,415   |
|                                | 7,742  | 11,735  | 11,005 | 11,443  | 41,925  |
| <b>Expenses</b>                |        |         |        |         |         |
| Corporate administration       | 732    | 1,262   | 718    | 686     | 3,398   |
| Exploration administration     | 433    | 371     | 524    | 642     | 1,970   |
| Capital taxes                  | 25     | 50      | 90     | 21      | 186     |
| Stock-based compensation       | 18     | 495     | 351    | 10      | 874     |
| Depreciation                   | 24     | 25      | 25     | 27      | 101     |
| Other expenses (income)        | (373)  | 3       | 352    | (804)   | (822)   |
|                                | 3,406  | 2,797   | 2,256  | 4,320   | 12,779  |
| Income and resource taxes      | (654)  | (562)   | (434)  | (851)   | (2,500) |
| Non-controlling interest       | (974)  | (1,187) | (980)  | (1,141) | (4,282) |
| <b>Net earnings</b>            | 1,778  | 1,048   | 842    | 2,328   | 5,997   |
| <b>Earnings per share</b>      | \$0.04 | \$0.02  | \$0.02 | \$0.05  | \$0.12  |

## Risks and Uncertainties

### *Mining Industry*

The exploration for, development and mining of mineral deposits involves significant risks which even a combination of careful evaluation, experience and knowledge may not eliminate. While the discovery of an ore body may result in substantial rewards, few properties which are explored are ultimately developed into producing mines. Major expenses may be required to establish ore reserves, to develop metallurgical processes and to construct mining and processing facilities at a particular site. It is impossible to ensure that the current exploration programs planned by the Corporation will result in a profitable commercial mining operation.

Whether a mineral deposit will be commercially viable depends on a number of factors, including the particular attributes of the deposit, such as size, grade and proximity to infrastructure, as well as metal prices which are highly cyclical and government regulations, including regulations relating to prices, taxes, royalties, land tenure, land use, importing and exporting of minerals and environmental protection. The exact effect of these factors cannot be accurately predicted, but the combination of these factors may result in the Company not receiving an adequate return on invested capital.

Mining operations generally involve a high degree of risk. The FNX's operations are subject to most of the hazards and risks normally encountered in the exploration, development and production of ore, including unusual and unexpected geology formations, rock bursts, cave-ins, flooding and other conditions involved in the drilling and removal of material, any of which could result in damage to, or destruction of, mines and other producing facilities, damage to life or property, environmental damage and possible legal liability. Although the Company does not operate processing facilities or tailings disposal areas, FNX does utilize third party facilities and adequate precautions to minimize risk will be taken. Milling operations are subject to hazards such as equipment failure or failure of retaining dams around tailings disposal areas which may result in environmental pollution and consequent liability.

FNX's activities are directed towards the search, evaluation, development and mining of mineral deposits. Some of the mineral properties in which the Company has an interest contain no known body of commercial ore and any exploration programs thereon are exploratory searches for ore, other properties in which the Company has an interest are subject to preliminary stages of exploration and development programs only, while other properties in which the Company holds an interest are in the production stage. There is no certainty that the expenditures to be made by the Company as described herein will result in discoveries of commercial quantities of ore. There is aggressive competition within the mining industry for the discovery and acquisition of properties considered to have commercial potential. FNX will compete with other interests, many of which have greater financial resources than it will have for the opportunity to participate in promising projects. Significant capital investment is required to achieve commercial production from successful exploration efforts.

### *Ore Processing*

FNX does not own the facilities used to process the ore mined. Although access to the Inco facilities is regulated by contract, there is no guarantee that future access will be available to the Company.

### *Mining Contractor Services*

FNX is dependent upon Dynatec to provide mining contractor services until December 31, 2007. Although these services are regulated by contract, there is no guarantee that Dynatec will be able to complete the contract with the Company.

### *Uncertainty of Reserve and Resource Estimates*

The figures for reserves and resources presented herein are estimates and no assurance can be given that the anticipated tonnages and grades will be achieved or that the expected level of recovery will be realized. The ore grade actually recovered may differ from the estimated grades of the reserves and resources. Such figures have been determined based upon assumed metal prices and operating costs. Future production could differ dramatically from reserve estimates for, among other reasons:

- mineralization or formations could be different from those predicted by drilling, sampling and similar examinations;
- increases in operating mining costs and processing costs could adversely affect reserves;
- the grade of the reserves may vary significantly from time to time and there is no assurance that any particular level of metals may be recovered from the ore; and
- declines in the market price of the metals may render the mining of some or all of the reserve uneconomic.

Any of these factors may require FNX to reduce its reserves estimates or increase its costs. Short-term factors, such as the need for the additional development of a deposit or the processing of new different grades, may impair the Company's profitability. Should the market price of the metals fall, FNX could be required to materially write down its investment in mining properties or delay or discontinue production or development of new projects.

### *Government Regulation*

The exploration and development activities of the Company are subject to various federal, provincial and local laws governing prospecting, development, production, taxes, labour standards and occupational health, mine safety, toxic substance and other matters. Exploration and development activities are also subject to various federal, provincial and local laws and regulations relating to the protection of the environment. These laws mandate, among other things, the maintenance of air and water quality standards, and land reclamation. These laws also set forth limitations on the generation, transportation, storage and disposal of solid and hazardous waste. Although FNX's exploration and development activities are currently carried out in accordance with all applicable rules and regulations, no assurance can be given that new rules and regulations will not be enacted or that existing rules and regulations will not be applied in a manner which could limit or curtail production or development. Amendments to current laws and regulations governing operations and activities of exploration and development, mining and milling or more stringent implementation thereof could have a substantial adverse impact on the Company.



Government approvals and permits are currently, and may in the future be, required in connection with Company's operations. To the extent such approvals are required and not obtained, the Company may be curtailed or prohibited from proceeding with planned exploration or development of mineral properties.

Failure to comply with applicable laws, regulations and permitting requirements may result in enforcement actions thereunder, including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. Parties engaged in mining operations may be required to compensate those suffering loss or damage by reason of the mining activities and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations.

Amendments to current laws, regulations and permits governing operations and activities of mining companies, or more stringent implementation thereof, could have a material adverse impact on the Company and cause increases in exploration expenses, capital expenditures or production costs or reduction in levels of production at producing properties or require abandonment or delays in development of new mining properties.

#### *Foreign Countries*

FNX holds direct or indirect interests in properties located in countries other than Canada, currently in Guinea, West Africa and may, in the future, acquire other properties outside of Canada. Mineral exploration and mining activities in these countries as well as elsewhere may be affected in varying degrees by political and financial instability, inflation and changes in government regulations relating to the mining industry. Any changes in regulations or shifts in political or financial conditions are beyond the control of the Company and may adversely affect its business. Operations may be affected in various degrees by laws and regulations with respect to, among other things, restrictions on production, price controls, export controls, exchange controls, income taxes, expropriation of property, social and environmental matters and mine safety.

#### *Permits and Licences*

The exploitation and development of mineral properties may require FNX to obtain regulatory or other permits and licences from various governmental licensing bodies. There can be no assurance that the in the future will be able to obtain all necessary permits and licences that may be required to carry out planned exploration, development and mining operations on its properties.

#### *Environmental Risks and Hazards*

All phases of FNX's operations are subject to environmental regulation in the various jurisdictions in which it operates. Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations. Environmental hazards may exist on the properties on which FNX holds interests which are unknown to the in the future at present which have been caused by previous or existing owners or operators of the properties. FNX may become liable for such environmental



hazards caused by previous owners and operators of the properties even where it has attempted to contractually limit its liability.

Production at mineral properties may involve the use of dangerous and hazardous substances. While all steps will be taken to prevent discharges of pollutants into the ground water and the environment, the Company may become subject to liability for hazards that cannot be insured against.

### *Commodity Prices*

The profitability of the Company will be significantly affected by changes in the market price for nickel and copper and by changes in the exchange rate of the United States dollar relative to the Canadian dollar. During 2006, a US\$1 per pound change in the price of nickel, or a US\$0.50 per pound change in the price of copper, is expected to generate a \$9.7 million change and a \$5.9 million change, respectively, in the Company's pre-tax profit and cash flow from operating activities as reported on its statement of operations and on its statement of cash flow. Each \$0.05 change in foreign exchange rates is expected to generate a pre-tax change of approximately \$2.1 million in FNX's profit as reported on its income statement.

FNX has not entered into any hedging agreements in respect of metal or foreign exchange at this time. Such contracts would prevent losses in situations when the price changed adversely and would prevent gains in situations where the price changed favourably.

The level of interest rates, the rate of inflation, world supply and demand of base metals and precious metals and stability of exchange rates can all cause significant fluctuations in base metal and precious metal prices. Such external economic factors are in turn influenced by changes in international investment patterns and monetary systems and political developments. The price of base metals and precious metals has fluctuated widely in recent years, and future serious price declines could cause continued commercial production to be impracticable. Depending on the price of base metals and precious metals, cash flow from mining operations may not be sufficient to cover operating costs. Any figures for reserves presented by the Company will be estimates and no assurance can be given that the anticipated tonnages and grades will be achieved or that the indicated level of recovery will be realized. Market fluctuations and the price of base metals and precious metals may render reserves uneconomical. Moreover, short-term operating factors relating to the reserves, such as the need for orderly development of the ore bodies or the processing of new or different grades of ore, may cause a mining operation to be unprofitable in any particular accounting period.

### *Uninsured Risks*

FNX carries insurance to protect against certain risks in such amounts as it considers adequate. Risks not insured against include environmental pollution or other hazards against which the Company cannot insure or against which it elects not to insure.

### *Conflicts of Interest*

Certain of the directors of FNX also serve as directors and/or significant shareholders of other companies involved in natural resource exploration and development and consequently there exists the possibility for such directors to be in a position of conflict. In the event that a director or executive officer has a material interest in any transaction being considered by the Company, any such conflict will be subject to and governed by procedures prescribed by the *Business*



*Corporations Act* (Ontario) (the "OBCA") which require a director or officer of a corporation experiencing such a conflict to disclose his interest and refrain from voting on any such matter unless otherwise permitted by the OBCA. In addition, Section 134 of the OBCA provides that every director must act honestly and in good faith with a view to the best interests of the Company. Section 134 is a formalization of the fundamental fiduciary duty that a director has to the corporation and encompasses, among other obligations, a duty of loyalty and a duty of confidentiality. As a fiduciary, a director may not interfere with, or take advantage of, any opportunities that rightfully belong to the Company. That a director may represent a specific shareholder of the Company does not relieve the director from fulfilling his fiduciary duty to FNX. If such director was to take any action which preferred the interests of a third party to the interests of the Company, such director would be liable to FNX for a breach of his fiduciary duty, regardless of any legal duties which such director may have to the third party.

#### *Land Title*

Although title to the Company's mineral properties has been reviewed by or on behalf of FNX and title opinions were delivered to the Company, no assurances can be given that there are no title defects affecting the properties. Title insurance generally is not available for mining claims in Canada, and FNX's ability to ensure that it has obtained secure claim to individual mineral properties or mining concessions may be severely constrained. The Company has not conducted surveys of the claims in which it holds direct or indirect interests; therefore, the precise area and location of such claims may be in doubt. Accordingly, the properties may be subject to prior unregistered liens, agreements, transfers or claims, including native land claims, and title may be affected by, among other things, undetected defects. In addition, the Company may be unable to operate the properties as permitted or to enforce its rights with respect to its properties.

#### *Joint Venture*

FNX may enter into one or more joint ventures in the future. Any failure of any joint venture partner to meet its obligations could have a material adverse affect on such joint ventures. In addition, the Company may be unable to exert influence over strategic decisions made in respect to properties subject of such joint ventures.

### **Corporate Governance**

Management and the Board of Directors (the "**Board**") of FNX recognize the value of good corporate governance and the need to adopt best practices. The Company's corporate governance practices over the last three years have advanced rapidly as a result of the Company's growth from a junior mining corporation to a member of the S&P/TSX Composite Index and changing rules and guidelines and best practices. FNX is committed to continuing to improve its corporate governance practices in light of its stage of development and evolving best practices and regulatory guidance.

The Board has adopted a Board Mandate outlining its responsibilities and defining its duties. The Board has four committees (the Audit, Compensation, Safety Health and Environment, and Corporate Governance and Nominating Committees). Each Board committee has an approved a committee charter, which outlines the committees' mandate, procedures for calling a meeting, and provides access to outside resources.



The Board has also approved a Code of Ethics, which governs the ethical behaviour of all employees, management and directors. Separate trading blackout and disclosure policies are also in place, as well as formal position descriptions for each of the Lead Director, Chairman/Chief Executive Officer and chairs of each of the committees of the Board. A whistle blowing procedure was adopted and all relevant policies, charters, mandates, codes and procedures are posted in the corporate governance section of FNX's website at [www.fnxmining.com](http://www.fnxmining.com). For more details on the Company's corporate governance practices, please refer to its website.

FNX's directors have expertise in exploration, mining, accounting, banking, legal, financing and the securities industry. The Board meets at least four times a year and Committees generally meet before full board meetings and as required. At every full Board meeting, the independent directors meet in camera. The Lead Director of the Company chairs the meeting of independent directors held at the end of every regular Board meeting. While the Company is subject to both the provisions of the Sarbanes-Oxley Act in the United States as a foreign issuer and Canadian regulatory provisions, the Board and management incorporate strong corporate governance practices in the belief that such practices provide protection for its investors and add value to the Company.

### **Disclosure Controls**

As of December 31, 2005, management evaluated the Company's disclosure controls and procedures as defined in the rules under the Canadian Securities Administrators and the US Securities and Exchange Commission. This evaluation was carried out under the supervision and participation of management, including the President and Chief Executive Officer and the Vice President and Chief Financial Officer. Based on that evaluation, the President and Chief Executive Officer and the Vice President and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective. No changes were made in our internal control over financial reporting during the year ended December 31, 2005, that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

### **Cautionary Note Regarding Forward Looking Statements**

Certain statements in this document constitute "forward-looking statements" within the meaning of Section 27A of the US Securities Act of 1933 and Section 21E of the US Securities Exchange Act of 1934. These forward looking statements are based on current expectations and involve risks and uncertainties, referred to above and/or in FNX's AIF dated March 30, 2006 and filed with Canadian provincial securities regulatory authorities, that could cause actual events or results to differ materially from estimated or anticipated events or results reflected in the forward looking statements. Examples of such forward looking statements include statements regarding financial results and expectations for 2006, including, but not limited to, interpretation of drill results, the geology, grade and continuity of mineral deposits and conclusions of economic evaluations, forecast levels of production of ore and/or metals, metal prices, demand for metals, currency exchange rates, cash operating margins, cash operating cost per pound of nickel sold, costs per ton of ore, expenditures on property, plant and equipment, increases and decreases in production, reserves and/or resources and anticipated grades and recovery rates and are or may be based on assumptions and/or estimates related to future economic, market and other conditions. Factors that could cause actual results, developments or events to differ materially from those anticipated include, among others, the factors described or referred to elsewhere herein and/or the AIF, and include unanticipated and/or unusual events. Many of such factors



are beyond FNX's ability to control or predict. Actual results may differ materially from those anticipated. Readers of this MD&A are cautioned not to put undue reliance on forward looking statements due to their inherent uncertainty. FNX disclaims any intent or obligation to update publicly any forward looking statements, whether as a result of new information, future events or results or otherwise. These forward looking statements should not be relied upon as representing management's views as of any date subsequent to the date of this MD&A.

Additional information, including quarterly and annual consolidated financial statements, AIF, Management Information Circular and other disclosure documents, may also be examined and/or obtained through the Internet by accessing FNX's website at [www.fnxmining.com](http://www.fnxmining.com) or by accessing the Canadian System for Electronic Document Analysis and Retrieval (SEDAR) website at [www.sedar.com](http://www.sedar.com).