



MANAGEMENT'S DISCUSSION AND ANALYSIS

Second Quarter Ended June 30, 2006

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This 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 and six month periods ended June 30, 2006, in comparison to the corresponding prior-year periods. This MD&A is prepared as at July 31, 2006, and is intended to supplement and complement the unaudited interim consolidated financial statements of FNX for the periods ended June 30, 2006 and 2005, which are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). This MD&A should also be read in conjunction with both the audited annual consolidated financial statements and annual MD&A included in the 2005 Annual Report and 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.

Executive Summary

The second quarter of 2006 established new benchmarks for FNX. During this quarter the Company reported higher revenues, earnings, cash margins and cash flow from operating activities, and produced more tons of ore, more pounds of copper, and more ounces of precious metals (platinum, palladium and gold) than in any previous quarter. In addition, the significant increase in by-product credits from copper and precious metal production resulted in a negative cash cost to produce a pound of nickel of US\$0.57 per pound during the second quarter of 2006.

The Company shipped and sold 154,090 tons of ore resulting in the sale of 2.0 million pounds of nickel, 2.6 million pounds of copper and 7,332 ounces of total precious metals during the second quarter of 2006. FNX realized revenues of US\$10.37 per pound of nickel sold and had negative cash costs, net of by-product credits, of US(\$0.57) per pound of nickel sold. The revenue per ton of ore sold was \$259 at a cash cost of \$103 per ton resulting in a cash operating margin per ton of ore sold of \$156. Nickel sales, along with significant by-product revenues from copper, platinum, palladium, gold and cobalt, resulted in operating revenues of \$40.0 million. Mine cash operating costs for the quarter totaled \$15.9 million, providing a cash operating margin of \$24.1 million.

Cash flow from operating activities was \$14.8 million in the second quarter of 2006, or \$0.18 per share, compared to \$3.6 million in 2005, or \$0.07 per share. Cash balances and working capital were \$137.6 million and \$147.6 million, respectively, at June 30, 2006 and the Company continued to be debt free.

As in the previous quarter, the main focus of the FNX exploration program during the second quarter was the high-grade copper-nickel-platinum-palladium-gold (Cu-Ni-Pt-Pd-Au) discoveries in the footwall of the Levack Mine. Drilling from underground and surface continues to expand the Levack Footwall Deposit in all directions, with the exploration program organized into a two-pronged approach. Underground drilling continues to be centred on systematic expansion of the deposit from the known mineralization, whereas drilling from surface platforms has been testing step-out targets in more distal contact, transitional and footwall positions in the same mineralized environment. Integral with this approach is on-going drilling at the associated Rob's Deposit, and in proximal footwall-hosted Cu-Ni-PGE mineralized zones (of which three are known) as their possible economic relationships with the Levack Footwall Deposit are investigated. Borehole UTEM (University of Toronto Electromagnetic) and RIM (Radio Imaging Method) geophysical surveys continue to be applied to refine geological models and drill targeting due to the excellent response of Cu-Ni-Pt-Pd-Au vein deposits such as the Levack discovery to such techniques. Access options continue to be assessed from the Company's Levack Mine underground infrastructure to ensure timely resource/reserve evaluation, and ultimately production, from the Levack Footwall Deposit. The discovery of the Levack Footwall Deposit was first reported in February 2005, and the most recent press release in February 2006 documented the significance and continued expansion of the discovery. This type of high-grade Cu-Ni-Pt-Pd-Au deposit is similar in geological setting, character, and mineralogy to other past, currently producing and "under-development" footwall-hosted vein systems elsewhere in the Sudbury mining district. Further results on the Levack Footwall Deposit exploration program will be released in the third quarter.

Activity on the Sudbury properties held by FNX's wholly owned Aurora Platinum Corp. ("Aurora") subsidiary included continued compilation, mapping and ground-truthing on the Foy properties in preparation for a future drill campaign and drilling of targets generated by a



detailed 3-D compilation exercise on the Falconbridge Footwall property. The Falconbridge Footwall drill program will continue throughout 2006.

Work programs for the 2006 field season have been finalized for Aurora properties in northwestern Ontario (Fishtrap Lake and Lansdowne House) and for the Temiscamingue and Midrim joint venture projects in the Temiscamingue region of west-central Quebec. The bulk of the programs are scheduled for completion in the third quarter.

At McCreedy West, mining at the Inter Main, 700 and PM Deposits continued in the second quarter. At Levack, the rehabilitation of the shaft compartments has reached the 2975 Level. Work is progressing on level rehabilitation, including general clean up, ground support and mine services, on the 1200, 1300, 1500 and 1800 levels. These levels have been identified for providing access to the near-term production targets in the mine. On the 2650 Level, initial assessment of the ground conditions, crusher station and ore pass system is favourable and work has started on level rehabilitation here. Shaft rehabilitation had reached the 2950 Level loading and spill pockets by the end of the second quarter. Shaft sinking at Podolsky had reached a depth of 2,570 feet by the end of the quarter. Excavation of the 2450 Level station was completed in the quarter.

No accidents or injuries were reported from FNX personnel during the second quarter of 2006. Unfortunately, there were two lost time accidents and one fatal injury reported by Dynatec Corporation ("**Dynatec**"), FNX's mining contractor, during the second quarter of 2006. There were no reportable environmental incidents in the quarter.

As discussed in a May 2006 press release FNX delisted its shares from trading on the American Stock Exchange ("**AMEX**") effective June 12, 2006. The Company has filed a Form 15 with the United States Securities and Exchange Commission ("**SEC**") seeking the deregistration of the Company's shares under section 12(b) of the Securities Exchange Act of 1934, as amended. Upon acceptance of deregistration by the SEC the Company will no longer be required to file certain reports, including Form 40-F and 6-K, with the SEC. The Company anticipates receiving acceptance from the SEC and completing deregistration before the end of the third quarter of 2006.

Key Economic Trends and Sensitivities

The MD&A included in FNX's 2005 Annual Report contained a discussion of the key economic trends that affect the Company and how they impact FNX's financial statements. This interim MD&A provides an update to reflect any significant changes in those trends since the preparation of the 2005 Annual MD&A. 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.

FNX plans to ship 635,000 tons of production and pre-production ore in 2006 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 total ounces of platinum, palladium and gold.

Nickel

Nickel accounted for approximately 57% of the Company's mine operating revenues in the second quarter of 2006, a slight decrease from 59% in the first quarter of 2006, however considerably less than the 79% in the second quarter of 2005. The cash settlement price of nickel on the London Metal Exchange ("LME") averaged US\$9.03 per pound in the second quarter of 2006, compared to an average of US\$6.72 per pound and US\$7.44 per pound in the first quarter of 2006 and the second quarter of 2005, respectively. The LME cash settlement price of nickel on July 31, 2006 was US\$12.34 per pound. Management continues to be of the view that the LME average cash settlement price for nickel will continue to be strong but volatile. Each US\$1.00 change in the price per pound of nickel is expected to generate a change in the Company's 2006 pre-tax annual earnings and cash flow from operating activities by approximately \$9.7 million.

Copper

Copper accounted for 27% of revenues in the second quarter of 2006, compared to 21% in the first quarter of 2006, and considerably higher than the 13% in the second quarter of 2005 as the PM Deposit had not commenced commercial production in the first six months of 2005. The LME cash settlement price for copper has continued to increase in the second quarter of 2006 and averaged US\$3.27 per pound, compared to US\$2.24 per pound in the first quarter of 2006 and US\$1.54 per pound in the second quarter of 2005. The LME cash settlement price of copper on July 31, 2006 was US\$3.56 per pound. Each US\$0.50 change in the price per pound of copper is expected to generate a change in the Company's 2006 pre-tax annual 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

The balance of FNX's revenues comes from the by-product production of platinum, palladium, gold and cobalt, which comprised 16% of FNX's revenues in the second quarter of 2006, compared to 21% of FNX's revenues in the first quarter of 2006 and 7% in the second quarter of 2005. The price of platinum increased from US\$968 per ounce at December 31, 2005 to US\$1,189 per ounce at June 30, 2006. The price of palladium increased from US\$254 per ounce at December 31, 2005 to US\$312 at June 30, 2006. The price of gold increased from



US\$517 per ounce on December 31, 2005 to US\$596 per ounce on June 30, 2006. The price of cobalt has increased from US\$12.60 per pound on December 31, 2005 to US\$14.44 per pound on June 30, 2006. The contribution to FNX's revenues from the sale of platinum, palladium and gold is expected to increase in 2006, compared to 2005.

Foreign exchange

FNX reports its financial results in Canadian dollars. While the Company's mine-site operating costs and most exploration and administration costs are in Canadian dollars, concentrating, smelting and refining costs and all metal sales are in United States dollars ("US\$"). The Canadian dollar appreciated relative to the US\$ as the average exchange rate for the second quarter of 2006 was \$1.12/US\$, compared to \$1.15/US\$ during the first quarter of 2006 and \$1.23/US\$ in the second quarter of 2005. The exchange rate was \$1.13/US\$ on July 31, 2006. Each \$0.05 change in exchange rates is expected to generate a change in the Company's 2006 pre-tax annual earnings and cash flow from operating activities by approximately \$2.1 million.

Financial Results

Overview

The following table presents a summary of FNX's Consolidated Statements of Operations and other cash flow data for the periods ended June 30, 2006 and 2005.

Table 1	Three Months Ended June 30			Six Months Ended June 30		
	2006	2005	Change	2006	2005	Change
	\$000s	\$000s	\$000s	\$000s	\$000s	\$000s
Mine operating revenues	39,981	24,231	15,750	66,780	43,288	23,492
Mine operating expenses ⁽¹⁾	(15,930)	(12,634)	(3,296)	(31,919)	(23,198)	(8,721)
Margin	24,051	11,597	12,454	34,861	20,090	14,771
Mine depreciation and amortization	(2,878)	(1,828)	(1,050)	(6,027)	(3,433)	(2,594)
Mining, net	21,173	9,769	11,404	28,834	16,657	12,177
Non-controlling interest	-	(2,286)	2,286	-	(3,819)	3,819
Earnings from operations	21,173	7,483	13,690	28,834	12,838	15,996
Administration	(2,362)	(2,205)	(157)	(5,275)	(4,129)	(1,146)
Capital taxes	(253)	-	(253)	(575)	-	(575)
Depreciation	(39)	(16)	(23)	(51)	(33)	(18)
Stock-based compensation	(531)	(259)	(272)	(1,133)	(361)	(772)
Taxes	6,481	(1,375)	7,856	4,425	(2,240)	6,665
Other (expenses) income	875	227	648	2,312	264	2,049
Net earnings	25,344	3,855	21,489	28,537	6,339	(22,198)
Basic and diluted EPS	\$0.30	\$0.08	\$0.22	\$0.34	\$0.13	\$0.21
Cash flow from operating activities	14,801	3,561	11,740	22,310	8,911	13,399
Cash flow per share	\$0.18	\$0.07	\$0.12	\$0.27	\$0.17	\$0.10

⁽¹⁾ Mine operating expenses exclude mine depreciation and amortization.

As described in the MD&A for 2005, FNX changed its accounting policy with respect to revenue recognition. Revenue is recognized at the time the ore is shipped, which is also the time that title transfers. 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 subsequent periods.

Operating revenues were \$40.0 million in the second quarter of 2006, 49% higher than in the first quarter of 2006, and were \$15.8 million, or 65%, higher than in the second quarter of 2005. FNX had net earnings of \$25.3 million, equal to \$0.30 per share for the quarter, compared to net earnings of \$3.9 million, or \$0.08 per share, in the same quarter last year and \$3.2 million, or \$0.04 per share, in the first quarter of 2006. Cash flow from operating activities was \$14.8 million in the second quarter, or \$0.18 per share, compared to \$7.4 million, or \$0.09 per share in the first quarter of 2006 and \$3.6 million, or \$0.07 per share, in the second quarter of 2005.

The second quarter of 2006 included a future income tax benefit of \$13.8 million as a result of a decrease in Canadian federal income tax rates. There were no other unusual items during the second quarter of 2006.

FNX's cash position at June 30, 2006 was \$5.5 million lower than at March 31, 2006. Working capital was \$147.6 million, an increase of \$2.0 million from March 31, 2006.

Metal Production and Sales

The following table presents a summary of FNX's metal production and sales information for the periods ended June 30, 2006 and 2005.

Table 2	Three Months Ended June 30			Six Months Ended June 30		
	2006	2005	Change	2006	2005	Change
Ore sold (tons)						
Nickel ore	79,018	88,762	(9,745)	157,792	167,677	(9,886)
Copper ore	75,072	22,070	53,003	143,686	26,491	117,196
Total ore	154,090	110,832	43,258	301,478	194,168	107,310
Grade of ore sold						
Nickel ore (%Ni)	1.5	1.7	(0.2)	1.5	1.7	(0.2)
Copper ore (%Cu)	1.8	3.6	(1.8)	1.7	4.6	(2.9)
Payable metal sold (000s lbs)						
Nickel	1,965	2,271	(306)	3,859	4,069	(210)
Non-controlling interest	-	(568)	568	-	(1,017)	1,017
Net to FNX	1,965	1,703	262	3,859	3,052	807
Copper						
Copper	2,594	1,719	875	4,669	2,814	1,855
Non-controlling interest	-	(430)	430	-	(704)	704
Net to FNX	2,594	1,289	1,305	4,669	2,110	2,559
Metal sales revenue						
Average Ni price (US\$/lb)	10.37	6.83	3.54	8.82	7.11	1.71
Average Cu price (US\$/lb)	3.76	1.49	2.27	3.12	1.48	1.64
Cdn\$/US\$ exchange rate	1.12	1.24	(0.12)	1.14	1.24	(0.10)
Total revenue (\$000s)	39,981	24,231	15,750	66,780	43,288	23,492
Revenue (\$/ton of ore sold)	259	219	40	222	223	(1)
Cash cost						
Mining (\$000s)	15,930	12,634	(3,276)	31,919	23,198	(8,721)
Cash cost (\$/ton of ore sold)	103	114	11	106	119	13
Cash cost (US\$/lb of Ni sold)	(0.57)	2.73	3.30	0.85	3.12	2.27

- Notes:
- All production figures are shown on a 100% basis with Dynatec's 25% interest in 2005 shown as non-controlling interest.
 - 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 and six month periods ended June 30, 2006 and 2005, respectively.
 - 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.
 - Copper grades reflect a blend of lower grade PM Deposit ore with higher grade ores from the 700 Zone.

Metal sales

Ore sold in the second quarter of 2006 totaled 154,090 tons, compared to 110,832 sold in the second quarter of 2005. Year to date ore sold totaled 301,478 tons, compared to 194,168 during the same period 2005, representing an increase of 55%. Nickel sales of 1,965,000 pounds in the second quarter of 2006 were 306,000 pounds less than the second quarter of 2005, and were 71,000 pounds more than in the first quarter of 2006. Copper sales in the second quarter of 2006 were 875,000 pounds more than in the same period in 2005, representing a 51% increase, and were 519,000 pounds higher than in the first quarter of 2006, representing a 25% increase. The total ounces of precious metals were 7,332 ounces during the second quarter of 2006, up from 6,959 in the first quarter of 2006, and 14,291 ounces year to date in 2006 representing a 157% increase from the 2,746 ounces produced during the first six months of 2005. Year-over-year metal sales increased primarily as a result of the PM Deposit reaching commercial production in May 2005.

Metal sales revenue

The nickel and copper contained in the ore that FNX sells to Inco Limited (“**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\$10.37 per pound and US\$8.82 per pound of nickel sold in the second quarter and year to date 2006, respectively, compared to US\$6.83 per pound and US\$7.11 per pound, respectively, last year. FNX realized US\$1.34 per pound of nickel more than the LME average price for the second quarter of 2006 as a result of \$6.2 million of additional revenue from the metal sales settlements related to metal sales that were provisionally priced in prior periods. These settlement variances arise as a result of the revenue recognition accounting policy adopted in 2005, whereby FNX recognizes revenue when ore is shipped and title passes. Provisional pricing is used at that time as the final prices are not determined until future periods. For nickel and copper, final pricing occurs two months after shipment. Year to date settlement variance revenue is \$8.1 million in 2006, compared to \$0.9 million during the same period in 2005.

The 9% year-over-year appreciation in the value of the Canadian dollar relative to the US dollar resulted in lower revenue in Canadian dollars than would otherwise have been realized.

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 second quarter of 2006 to previous periods.

Table 3	Q2-2006 compared to Q2-2005	YTD-2006 compared to YTD-2005	Q2-2006 compared to Q1-2006
	\$000s	\$000s	\$000s
Increase (decrease) in nickel sold:			
<i>Number of pounds sold (000s lbs)</i>	(307)	(210)	71
Change in revenue due to quantity	(2,604)	(1,850)	592
<i>Price per pound sold (US\$/lb)⁽¹⁾</i>	3.51	1.70	3.12
Change in revenue due to price	6,105	4,670	6,423
Net change in sales revenue	3,501	2,820	7,015

⁽¹⁾ The price of nickel is quoted in US dollars. FNX, however, reports revenue in Canadian dollars. As a result of the approximately 9% appreciation in the Canadian dollar compared to the US dollar from the second quarter of 2005 to the second quarter of 2006, 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 \$15.9 million in the second quarter of 2006, consistent with the first quarter of 2006, and \$3.3 million higher than the second quarter of 2005. 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 negative US\$0.57 for the quarter, US\$3.30 per pound lower than in the second quarter of 2005 and US\$2.85 per pound lower than in the first quarter of 2006 due to the significantly higher by-product credit revenue. The cash operating cost per pound benefited from higher by-product credits in 2006. Cash operating costs were \$3.3 million higher in the second quarter of 2006, compared to the second quarter of 2005, due to the higher number of tons of ore sold and was US\$0.1 million lower than in the first quarter of 2006.

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

Table 4	Three months ended June 30, 2006			Three months ended June 30, 2005		
	C\$000s	US\$000s	US\$/lb	C\$000s	US\$000s	US\$/lb
Operating expenses ⁽¹⁾	15,930	14,195	7.22	12,634	10,156	4.47
By-product credits:						
Copper	(10,879)	(9,694)	(4.93)	(3,180)	(2,556)	(1.13)
Other ⁽²⁾	(6,304)	(5,618)	(2.86)	(1,754)	(1,410)	(0.61)
Cash operating costs	(1,253)	(1,117)	(0.57)	7,700	6,190	2.73
Nickel sold (000s lbs)		1,965			2,271	

Table 4 (continued)	Six months ended June 30, 2006			Six months ended June 30, 2005		
	C\$000s	US\$000s	US\$/lb	C\$000s	US\$000s	US\$/lb
Operating expenses ⁽¹⁾	31,919	28,041	7.27	23,198	18,776	4.61
By-product credits:						
Copper	(16,440)	(14,443)	(3.74)	(5,168)	(4,183)	(1.02)
Other ⁽²⁾	(11,759)	(10,330)	(2.68)	(2,358)	(1,909)	(0.47)
Cash operating costs	3,720	3,268	0.85	15,672	12,684	3.12
Nickel sold (000s lbs)		3,859			4,069	

(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 be higher in 2006 compared to 2005 as a result of greater quantities of ore mined and sold due to the commencement and ramp up of 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 \$2.9 million in the second quarter of 2006, compared to \$1.8 million in the second quarter of 2005. Mine depreciation and amortization expense will be higher in 2006, compared to 2005, due to the increase in production rates from ramping up the PM Deposit and the additional amortization associated with the significantly higher carrying value of the McCreedy West mine as a result of the Company's purchase of Dynatec's 25% interest in the former Sudbury Joint Venture ("**SJV**") and 50% interest in Aurora (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 \$156 per ton in the second quarter of 2006, compared to \$74 per ton in first quarter of 2006 and \$116 per ton in the second quarter of 2005. By-product credits were the main factor contributing to the higher margin in 2006, compared to the second quarter of 2005, thereby contributing to the higher cash operating margin per ton of ore sold in 2006.



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

Table 5	Three months ended		Six months ended	
	June 30		June 30	
	2006	2005	2006	2005
	\$/ton	\$/ton	\$/ton	\$/ton
Mine operating revenue	259	219	222	223
Mine operating expenses ⁽²⁾	(103)	(114)	(106)	(119)
Cash operating margin per ton of ore sold	156	105	116	104

(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 volatile, grades forecast 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

Administration

Administration expenses were \$2.4 million and \$5.3 million in the second quarter and year to date 2006, respectively, compared to \$2.2 million and \$4.1 in 2005. Administration expenses were higher this year, primarily due to the addition of personnel to assist in facilitating the growth of FNX's business as a result of the Dynatec Transaction and for annual bonuses for exceeding corporate objectives for the 2005 year.

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 \$0.5 million in the second quarter of 2006, compared to \$0.6 million in the first quarter and \$0.3 million in the second quarter of 2005. Year to date stock-based compensation was \$1.1 million in 2006, an increase of \$0.8 million from the same period in 2005 as a result of FNX's share appreciation during this period. In the second quarter of 2006, 165,000 stock options were granted, 50,000 expired, and 9,000 were cancelled, while in the second quarter of 2005 options to purchase 201,000 shares were granted and none expired or were cancelled.

Other expenses (income)

Other expenses (income) resulted in net income of \$0.9 million and \$2.3 million in the second quarter and year to date of 2006, respectively, compared to net income of \$0.2 million and \$0.3 million, respectively, in 2005. Other income primarily consists of interest income on cash and cash equivalents of the Company.

Provision for income and resource taxes and provincial capital taxes

In the second quarter of 2006 FNX reported a net recovery of income taxes of \$6.5 million, compared to a provision for taxes of \$2.1 million in the first quarter of 2006. Year to date the Company has income taxes recoverable of \$4.4 million, compared to an income tax provision of \$2.2 million during the first six months of 2005. In June 2006, the Government of Canada enacted legislation reducing corporate tax rates over a period of several years. During the second quarter FNX recorded a future income tax recovery of \$13.8 million to reflect the positive impact of these tax rate reductions on transactions in prior years for which future taxes will be paid. Quarterly pre-tax earnings attracted income and resource taxes at an effective rate of 38%, or \$7.3 million, and when combined with the aforementioned future income tax liability adjustment resulted in a net \$6.5 million tax recovery. No cash income taxes or resource taxes were payable in either 2005 or 2006, as the Company continues to have sufficient income and resource tax deductions available to reduce cash taxes to nil.

Many provincial jurisdictions, including the Province of Ontario, charge a tax based on a corporation's taxable capital. This expense, however, is deductible in the determination of taxable income and the Company separately discloses it in the statement of operations. Primarily as a result of the issuance of 20,500,000 common shares to Dynatec under the Dynatec Transaction 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 at June 30, 2006 for provincial capital tax purposes is significantly higher than at June 30, 2005. Accordingly, FNX charged to earnings \$0.3 million and \$0.6 million in provincial capital tax expense for the second quarter of 2006 and year to date, respectively, compared to \$nil in 2005.

Non-controlling interest

As a result of the Dynatec Transaction in October 2005, which resulted in the termination of the SJV, the non-controlling interest has been eliminated.

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.

EBITDA

Earnings before interest income and expense, income and capital taxes, stock-based compensation and depreciation and amortization ("**EBITDA**"), a non-GAAP performance measure (please see discussion under non-GAAP Performance Measures below), was \$21.3 million during the second quarter of 2006, \$14.0 million higher than in the second quarter of 2005 and \$12.7 million higher than in the first quarter of 2006. The EBITDA for the six months ended June 30, 2006 was \$18.8 million higher than the same period in 2005.



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

Table 6	Three months ended		Six months ended	
	June 30		June 30	
	2006	2005	2006	2005
	\$000s	\$000s	\$000s	\$000s
Mine operating revenue	39,981	24,231	66,780	43,288
Mine operating expenses ⁽¹⁾	(15,930)	(12,634)	(31,919)	(23,198)
Cash operating margin	24,051	11,597	34,861	20,090
Administration	(2,362)	(2,205)	(5,276)	(4,129)
Other (expenses) income ⁽²⁾	(421)	(16)	(313)	(268)
Non-controlling interest ⁽³⁾	-	(2,899)	-	(5,023)
EBITDA	21,268	6,477	29,272	10,670

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

(2) Excludes interest income and interest expense.

(3) Calculated as 25% of cash operating margin.

Financial Condition and Liquidity

Cash and cash flows

Cash flow from operating activities totaled \$14.8 million and \$22.3 million in the second quarter and year to date 2006, respectively, compared to \$3.6 million and \$8.9 million, respectively in 2005. The cash flows were significantly higher in 2006 due to higher realized metal prices resulting in a higher cash operating margin and greater quantities of ore mined and sold due to the commencement and ramp up of production from the PM Deposit.

Financing activities in the second quarter of 2006 resulted in net cash inflows of \$0.2 million and \$0.8 million in the second quarter and year to date, respectively, from the issuance of 22,000 common shares for stock options exercised under the Company's stock option plan. 2005 financing activities were higher as a result of cash contributions from the former SJV.

Investing activities for the second quarter of 2006 resulted in net cash outflows of \$20.4 million, compared to \$8.8 million in 2005. Exploration, development and equipment expenditures that were capitalized as property, plant and equipment totaled \$36.5 million for the year to date 2006 and are budgeted to total \$97 million for the entire year.

The net change in cash balances as a result of operating, financing and investing activities was a net cash outflow of \$5.5 million since December 31, 2005, compared to \$1.6 million during the comparative period in 2005. FNX remains debt free and the Company's cash position of \$137.6 million at June 30, 2006, is sufficient to meet all planned cash expenditures in 2006.

Working capital

Working capital increased \$2.0 million during the second quarter of 2006 to \$147.6 million, primarily due to higher accounts receivable, and decreased \$5.6 million year to date, primarily as a result of increased capital expenditures.

Reclamation and other deposits

Reclamation deposits remained unchanged at \$1.6 million from the first quarter of 2006 and include various amounts with government agencies in the Province of Ontario in connection with the McCreedy West 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. The deposit will ultimately be applied against Dynatec's invoice for December 2007.

Investments

FNX continues to hold 7,716,594 million common shares of Dynatec, 13,300,000 million common shares of Lake Shore Gold Corp., 6,860,715 common shares of Superior Diamonds Inc., and 3,150,230 common shares and 2,347,886 share purchase warrants in International Nickel Ventures Corporation ("**INV**"), all of which are publicly traded corporations. The combined book value was \$30.4 million and, as at June 30, 2006, the market value was \$41.4 million.

Property, plant and equipment

(i) Summary

Acquisition costs and expenditures on property, plant and equipment totaled approximately \$20.4 million during the second quarter of 2006 and \$36.5 million year to date. 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 following table shows the net increase in property, plant and equipment expenditures for 2006 by property location.

Table 7	Six months ended June 30, 2006	Three months ended June 30, 2006	Three months ended March 31, 2006
	\$000s	\$000s	\$000s
Aurora Properties	1,432	889	543
McCreedy West	5,718	4,490	1,228
Kirkwood	44	21	23
Levack	13,823	8,106	5,717
Levack Footwall	5,976	2,779	3,197
Podolsky	9,114	4,023	5,091
Victoria	12	3	9
	36,119	20,311	15,808
Corporate	356	112	244
	36,475	20,423	16,052

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. Capital expenditures at Podolsky in 2006 are budgeted at \$28 million and involved 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, 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.

(ii) Sudbury Basin properties

On January 10, 2002, FNX entered into an agreement with Dynatec, pursuant to which Dynatec acquired 25% of FNX's 100% interest in the mineral rights to five former Inco mineral properties located in the Sudbury Basin, Ontario (Kirkwood, Levack, McCreedy West, Podolsky and Victoria, collectively, the "**Properties**") and FNX and Dynatec formed a joint venture known as the SJV, with FNX holding a 75% interest and Dynatec a 25% interest. Inco retained certain processing and other rights on the Properties. FNX managed exploration activities relating to the SJV and Dynatec managed mining operations.

On October 21, 2005, FNX and Dynatec closed the Dynatec Transaction whereby FNX increased its ownership to 100% of the SJV assets by acquiring Dynatec's 25% interest in the SJV and 50% interest in Aurora. Accordingly, FNX now holds a 100% interest in the Properties, including the Aurora Properties in Sudbury and elsewhere.

(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. FNX holds a 100% interest in McCreedy West.

(iv) Planned shut down

In July 2006, Inco initiated their planned three week maintenance shut down, during which time FNX's crusher plant was upgraded, and routine maintenance was performed. During this period reduced quantities of nickel ore were mined, while mining and shipment of copper ore continued throughout the month to the Inco Mill where it was stockpiled for processing.

(v) *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. 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:

Table 8	June 30 2006	December 31 2005
	\$000s	\$000s
Aurora Properties	93,555	92,123
Kirkwood	1,644	1,600
Levack	95,332	81,509
Levack Footwall	225,164	219,188
Podolsky	78,510	69,396
Victoria	6,187	6,175
	500,392	469,991

FNX holds 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. 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 and, as Falconbridge is not participating in the 2006 exploration program, Falconbridge's interest continues to be diluted. 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 second quarter, FNX drilled 55,215 feet of exploration diamond drilling in 77 holes. The following table details the drilling by property and has been adjusted to reflect the drilling of exploration holes only (definition drilling holes are not reported).

Table 9	Three months ended June 30, 2006		Six months ended June 30, 2006	
	# Holes	# Feet	# Holes	# Feet
Levack	23	8,583	40	18,979
McCreedy West – Exploration	11	8,610	14	11,660
Levack Footwall	38	28,858	56	81,845
Podolsky	1	819	2	2,344
Aurora Properties	4	8,345	6	9,932
	77	55,215	118	124,760

Exploration drilling at Levack was primarily focused on delineating the up-dip extension of the #7 extension orebody from the 1200 Level. Late in the quarter Levack drilling shifted to confirmation and delineation drilling in the 10670 Cross-cut (1200 Level) and the 9300 pod of the #7 orebody from



1850 Level. The exploration drilling at McCreedy West during the second quarter of 2006 was focused on the continued expansion of the PM Deposit from underground platforms. One borehole at Podolsky was drilled to test a surface Induced Polarization, or IP, survey anomaly near the North Zone.

The main focus of drilling remains the Levack Footwall Deposit and, as reported in a press release during the first quarter, results continue to expand the mineralized system, and confirm its grade and potential.

The drilling program on the Aurora Properties, initiated by FNX in 2005, continued during the second quarter of 2006 with a focus on the Falconbridge Footwall environment.

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 2005. 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% was 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.

Non-controlling interest

Net cash payments from non-controlling interest were eliminated.

Share capital

During the second quarter of 2006, share capital increased by \$0.2 million from \$559.8 million to \$560.0 million as a result of the exercise of 22,000 stock options. Year to date share capital has increased by \$1.1 million as a result of the exercise of 181,500 stock options. During the second quarter of 2005, 704,000 common shares were issued upon the exercise of stock options for total cash consideration of \$3.2 million. As at June 30, 2006, stock options to purchase 2.5 million common shares at a weighted average of \$8.74 per share were outstanding. The number of stock options outstanding as at July 31, 2006 represents 3.0% of the issued and outstanding common shares as at that time.

During the first two quarters of 2005, share capital decreased by \$3.0 million from \$126.4 million to \$123.4 million as a result of the recognition of an \$8.7 million future tax liability associated with the renunciation of \$20.6 million of Canadian Exploration Expenses ("CEE") to flow-through common shareholders. All \$20.6 million of flow-through funds were expended on CEE by the end of 2005.

On March 16, 2005, as amended, the Board of Directors approved the implementation of a deferred share unit plan (the "DSU Plan"), effective July 1, 2005. The purpose of the DSU Plan is to promote a greater alignment of interests between shareholders and Directors and executive employees by linking a portion of Director compensation and executive employee bonuses to the future value of FNX's common shares. The DSU Plan is only eligible to Directors and executive employees of FNX and is to allow Directors and executive employees the choice to receive, in increments of 25%, up to 100% of their director compensation or management bonus in the form of DSUs rather than by way of cash. Under the terms of the DSU Plan, the number of DSUs granted is based upon the fair market value of FNX's common shares at that time. DSUs are only paid out upon the Director's or



executive employee's death or resignation from the Board or the Company. Included in accrued liabilities is \$0.4 million related to 33,457 DSUs.

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.

Related Party Transactions

In periods prior to December 31, 2005, FNX had acquired 2,320,230 common shares and 2,347,886 common share purchase warrants of INV, which was a private mineral prospecting company at such time. The President and Chief Executive Officer of FNX (who is also a director of FNX and a director of INV), two other directors and two senior officers of FNX also invested in INV. As part of an initial public offering by INV, on March 17, 2006, FNX purchased an additional 830,000 common shares of INV for cash consideration of \$996,000. As at June 30, 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 common share purchase warrants at an exercise price of \$1.40 per common share.

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 as well as the non-exclusive services of certain personnel, all in consideration of a flat fee of \$10,000 per month. These services and facilities include commercially reasonable office facilities and communication equipment and the non-exclusive services of certain FNX personnel, including the Vice President and Chief Financial Officer of FNX who is also the Vice President and Chief Financial Officer of the Corporation, as well as accounting staff as required by the Vice President and Chief Financial Officer of INV and administrative staff as required by INV. The services provided by these personnel are limited to 20% of the time of each such individual per week on the basis of a 40 hour work week. In addition, the non-exclusive services of the Vice President Business Development of FNX (who also serves as the President and Chief Executive Officer of INV) and the Vice President of Investor Relations of FNX (who also serves as the Director of Investor Relations for INV) are provided to INV pursuant to the agreement in consideration of the reimbursement to FNX of an amount equal to the salary and benefits paid by FNX to each such officer, multiplied by the percentage of their respective time spent providing services to INV. The services provided by the Vice President of Investor Relations of FNX are limited to 20% of the time of such individual per week on the basis of a 40 hour work week. No similar limitations apply to the services provided by the Vice President Business Development of FNX. The agreement may be terminated by either party at any time upon the provision of 30 days written notice to the other party, at nominal cost. During the three and six months ended June 30, 2006, FNX invoiced INV \$0.1 million and \$0.2 million, respectively, for services provided under the agreement.

Non-GAAP Performance Measures

Cash operating margin per ton of ore sold, cash operating cost per pound of nickel sold and 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.

Outstanding Share Data

As at June 30, 2006, stock options to purchase 2.5 million common shares at a weighted average price of \$8.74 per share were outstanding. The number of stock options outstanding at June 30, 2006 represents 3.0% of the issued and outstanding common shares at that time. The number of common shares issued and outstanding as at June 30, 2006 totaled 83.7 million. From July 1, 2006 to July 31, 2006, 12,000 stock options have been granted, nil were cancelled and nil have been exercised. As at July 31, 2006, the Corporation had 83,711,472 common shares outstanding and stock options to purchase 2,542,500 common shares had been granted and were outstanding.

Summary of Selected Quarterly Financial Information

Table 10	Q1	Q2	Q3	Q4	Total
	\$000s	\$000s	\$000s	\$000s	\$000s
2006					
Revenue	26,799	39,981			66,780
Net earnings	3,193	25,344			28,537
Basic and diluted EPS	\$0.04	\$0.30			\$0.34
2005					
Revenue	19,057	24,231	18,588	22,726	84,602
Net earnings (loss)	2,484	3,855	(2,218)	477	4,597
Basic and diluted EPS	\$0.05	\$0.08	(\$0.04)	\$0.01	\$0.08
2004					
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

The quarterly trend since 2004 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 in May 2005 the Company’s revenues should continue to increase.

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 1943. 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 or by accessing the Canadian System for Electronic Document Analysis and Retrieval (SEDAR) website at www.sedar.com.