

Klondex Mines Ltd.
Interim Consolidated Financial Statements
(Unaudited)
September 30, 2009

Klondex Mines Ltd.**Interim Consolidated Financial Statements**

September 30, 2009

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Klondex Mines Ltd.**Interim Consolidated Balance Sheets**

	September 30, 2009 (Unaudited)	December 31, 2008
Assets		
Current		
Cash and cash equivalents (note 3)	\$ 4,400,062	\$ 1,848,289
Marketable securities (note 4)	220	108
Prepaid expenses	19,501	18,102
Accounts receivable	34,605	18,322
	4,454,388	1,884,821
Rent deposit (note 5)	8,735	14,054
Property and equipment (note 6)	23,484	31,976
Mineral properties and related deferred expenses (note 7)	22,807,610	21,282,764
Reclamation bonds (note 8)	190,101	217,122
	\$ 27,484,318	\$ 23,430,737
Liabilities		
Current		
Accounts payable and accruals	\$ 337,879	\$ 988,308
Overdraft – brokerage account (note 3)	-	1,107,398
Due to related parties (note 13)	116,286	147,555
Asset retirement obligation (note 8)	190,101	217,122
	644,266	2,460,383
Deferred lease inducement (note 15)	1,657	4,113
	645,923	2,464,496
Shareholders' Equity		
Share capital (note 9)	37,019,368	29,566,689
Contributed surplus (notes 9 and 10)	2,577,881	2,186,083
Deficit	(12,758,854)	(10,786,531)
	26,838,395	20,966,241
	\$ 27,484,318	\$ 23,430,737

Nature of operations (note 1)
Commitments (notes 7, 8 and 15)
Contingency (note 16)
Subsequent events (note 17)

Approved on behalf of the Board of Directors:

William J. Solloway (sgd.) Director

Brendan Donohoe (sgd.) Director

The accompanying notes are an integral part of the consolidated interim financial statements.

Klondex Mines Ltd.**Interim Consolidated Statements of Loss, Comprehensive Loss and Deficit (Unaudited)**

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2009	2008	2009	2008
Administrative Expenses				
Amortization	\$ 3,160	\$ 2,906	\$ 8,647	\$ 8,661
Consulting fees (Note 13)	79,602	31,991	214,578	96,622
Legal, audit and accounting (Note 13)	268,955	29,374	441,694	90,908
Management fees and salaries (Note 13)	50,342	25,660	159,977	78,234
Office and miscellaneous	31,154	35,421	114,308	73,052
Other item	-	-	-	19,934
Stock based compensation (Note 10)	-	24,500	854,148	183,670
Telephone	5,345	4,069	15,018	12,837
Transfer agent and regulatory fees	6,508	29,519	45,243	57,833
Travel, conferences and meetings	48,708	21,211	111,294	151,831
Foreign exchange (gain)	38,229	(9,802)	9,799	(50,988)
Interest earned	(557)	4,505	(2,248)	(49,279)
	531,446	199,354	1,972,458	673,315
Other item				
Unrealized gain on marketable securities	(88)	-	(135)	-
Net and comprehensive loss for the period	(531,358)	(199,354)	(1,972,323)	(673,315)
Deficit, beginning of period	(12,227,496)	(10,106,354)	(10,786,531)	(9,632,393)
Deficit, end of period	\$(12,758,854)	\$(10,305,708)	\$(12,758,854)	\$(10,305,708)
Basic and diluted loss per share	\$ (0.02)	\$ (0.01)	\$ (0.07)	\$ (0.03)
Weighted average number of shares outstanding	30,150,448	23,976,117	27,464,048	23,318,488

The accompanying notes are an integral part of the consolidated interim financial statements.

Klondex Mines Ltd.**Interim Consolidated Statements of Deferred Acquisition and Exploration Expenses**

Nevada Properties	Nine Months Ended September 30, 2009 (Unaudited)	Year Ended December 31, 2008
Balance, beginning of period	\$ 21,282,764	\$ 15,769,182
Acquisition of land	53,610	297,560
Advance – Drilling	107,220	(99,293)
Assays and core costs	64,221	549,046
Consulting	282,345	363,745
Drilling	648,962	3,767,091
Environmental consulting and permitting	29,275	282,918
Field supplies and equipment	44,142	155,337
Geophysics	112,879	31,123
Lease payments, taxes and royalties	22,517	17,944
Legal	345	1,915
Maintenance fees	95,209	75,351
Mapping and sampling	785	520
Miscellaneous	40,883	57,026
Site visits	22,453	13,299
Current period expenditures	1,524,846	5,513,582
Balance, end of period	\$ 22,807,610	\$ 21,282,764

The accompanying notes are an integral part of the consolidated interim financial statements.

Klondex Mines Ltd.**Interim Consolidated Statements of Cash Flows (Unaudited)**

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2009	2008	2009	2008
Cash provided by (used in)				
Operating activities				
Loss for the period	\$ (531,358)	\$ (199,354)	\$ (1,972,323)	\$ (673,315)
Items not involving cash				
Amortization	3,160	2,906	8,647	8,661
Deferred lease inducement realized	(819)	(819)	(2,456)	(2,456)
Stock based compensation	-	24,500	854,148	183,670
Unrealized foreign exchange (gain) loss	26,436	(23)	44,648	(37)
Unrealized (gain) on marketable securities	(88)	-	(135)	-
	(502,669)	(172,790)	(1,067,471)	(483,477)
Change in non-cash working capital				
Accounts receivable	(20,581)	11,741	(16,283)	32,628
Prepaid expenses	(13,550)	3,698	(1,399)	(9,851)
Accounts payable	(41,312)	(15,902)	114,410	(151,228)
Rent deposit	-	-	5,319	-
	(578,112)	(173,253)	(965,424)	(611,928)
Financing activities				
Issue of share capital	2,347,500	2,152,238	7,210,250	2,152,238
Share issue cost, cash	(17,909)	(96,463)	(219,921)	(96,463)
Due to (from) related parties	(220,048)	16,753	(41,891)	60,668
	2,190,543	2,072,528	6,948,438	2,116,443
Investing activities				
Purchase of property & equipment	-	(510)	-	(2,542)
Accounts payable related to mineral properties	(222,820)	(304,375)	(788,999)	161,606
Deferred exploration	(1,181,469)	(1,901,965)	(1,524,846)	(4,752,896)
	(1,404,289)	(2,206,850)	(2,313,845)	(4,593,832)
Effect of foreign exchange on cash balances	(5,924)	-	(9,998)	-
Net increase (decrease) in cash and equivalents	121,218	(307,575)	3,659,171	(3,089,317)
Cash and equivalents, beginning of period	4,278,844	1,457,680	740,891	4,239,422
Cash and equivalents, end of period	\$ 4,400,062	\$ 1,150,105	\$ 4,400,062	\$ 1,150,105

Supplemental Cash Flow Information (notes 3 and 11)

The Company had the following cash transactions:

Interest received	\$ 557	\$ (4,505)	\$ 2,248	\$ 79,279
Income taxes paid	-	-	-	-

The accompanying notes are an integral part of the consolidated interim financial statements.

Klondex Mines Ltd.

Notes to the Interim Consolidated Financial Statements (Unaudited)

September 30, 2009

1. Nature of Operations

The Company is in the business of owning, acquiring, exploiting, exploring, developing and evaluating mineral properties, and either joint venturing or developing these properties further or disposing of them when the evaluation is completed. The Company has interests in the properties all located in the State of Nevada, USA.

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis, which presume the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. As at September 30, 2009, the Company had working capital of \$3,810,122 (December 31, 2008 - \$575,562 working capital deficit). The Company's ability to continue as a going concern is dependent upon achieving profitable operations and upon obtaining additional financing. While the Company is expending its best efforts in this regard, the outcome of these matters can not be predicted at this time. These financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue in business.

The recoverability of amounts shown as mineral properties and deferred exploration costs is dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete their development, and future profitable production or disposition thereof. The Company is considering a number of alternatives to secure additional capital including additional funding facilities or equity raisings.

2. Significant Accounting Policies

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a basis consistent with those followed in the most recent audited financial statements. These unaudited interim consolidated financial statements do not include all the information and footnotes required by generally accepted accounting principles for annual financial statements. Therefore readers are advised to refer to the Company's annual audited financial statements for the year ended December 31, 2008 for additional information.

Accounting Policies to be Adopted

International Financial Reporting Standards

In January 2006, the CICA Accounting Standards Board (AcSB) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") by the end of 2011. The impact of the transition to IFRS on the Company's financial statements has not yet been determined.

Klondex Mines Ltd.**Notes to the Interim Consolidated Financial Statements (Unaudited)**

September 30, 2009

2. Significant Accounting Policies (continued)**Business Combinations**

In January 2009, the CICA issued Handbook Section 1582, Business Combinations, which replaces the existing standards. This section establishes the standards for the accounting of business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair value. Estimated obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This standard is equivalent to the International Financial Reporting Standards on business combinations. This standard is applied prospectively to business combinations with acquisition dates on or after January 1, 2011. Earlier adoption is permitted. This standard will not have any impact on the Company's financial statements.

Consolidated financial statements

In January 2009, the CICA issued Handbook Section 1601, consolidated financial statements, which replaces the existing standards. This section establishes the standards for preparing consolidated financial statements and is effective for interim and annual consolidated financial statements beginning on or after January 1, 2011. This standard will not have an impact on the Company's financial statements.

Non controlling interests

In January 2009, the CICA issued Handbook Section 1602, Non-controlling interests, which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. This standard is equivalent to the International Financial Reporting Standards on consolidated and separate financial statements. This standard is effective for interim and annual consolidated financial statements beginning on or after January 1, 2011. This standard will not have an impact on the Company's financial statements.

3. Cash and cash equivalents

	September 30, 2009	December 31, 2008
Cash on deposit	\$ 216,064	\$ 308,429
Jones Gable Canadian and US \$ accounts	4,183,998	1,539,860
	4,400,062	1,848,289
Jones Gable US account (overdraft)	-	(1,107,398)
	\$ 4,400,062	\$ 740,891

4. Marketable securities

On May 18, 2009, Coeur D'Alene announced a reverse stock split at a split ratio of 1-for-10. The reverse stock split took effect on May 26, 2009. As at September 30, 2009, the Company holds 10 shares of Coeur D'Alene Mines with a market value of \$220 (US\$205).

Klondex Mines Ltd.**Notes to the Interim Consolidated Financial Statements (Unaudited)**

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5. Rent Deposit

As part of the lease agreement, the Company paid the last three months of the fourth year (2009) and the last four months of the fifth year (2010) of the lease term in advance. During the first quarter, the Company received a partial refund of \$5,319. These deposits bear interest at approximately 4% per annum, receivable at the end of the fourth and fifth year of the lease term.

6. Property and Equipment

	September 30, 2009		
	Cost	Accumulated amortization	Net book value
Computer equipment	\$ 37,905	\$ 26,486	\$ 11,419
Telephone equipment	1,376	1,017	359
Furniture and fixtures	29,068	20,402	8,666
Leasehold improvements	24,736	21,696	3,040
	\$ 93,085	\$ 69,601	\$ 23,484

	December 31, 2008		
	Cost	Accumulated amortization	Net book value
Computer equipment	\$ 37,905	\$ 23,205	\$ 14,700
Telephone equipment	1,376	964	412
Furniture and fixtures	29,068	18,838	10,230
Leasehold improvements	24,736	18,102	6,634
	\$ 93,085	\$ 61,109	\$ 31,976

7. Mineral Property and Related Deferred Exploration Expenses**a) Fire Creek Gold Properties, Lander County, Nevada, U.S.A.**

The Company has a 100% ownership interest in this land block which has been expanded to a total of 484 claims, or 9,680 acres, and fee lands of 1,428 acres. In 1988, the Company entered into an agreement with two joint venturers to explore and develop the gold property. Under the terms of the agreement, Klondex received an advance minimum royalty of \$10,000 per month. The joint venturers terminated the agreement on March 31, 1999. As a result the Company has regained 100% ownership of the property and is not obligated to repay the advance royalty payments amounting to \$1,582,162 (US\$1,220,000). During fiscal 2002, the Company purchased the drill cores and data from the joint venturers for consideration of US\$4,000 and issuance of 15,000 common shares of the Company.

Klondex Mines Ltd.**Notes to the Interim Consolidated Financial Statements (Unaudited)**

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7. Mineral Property and Related Deferred Exploration Expenses (continued)**b) Lander & Eureka Counties, Nevada**

During fiscal 2006, the Company entered into an option agreement to acquire a 100% interest (the "Option") in certain lands located in Lander & Eureka Counties, Nevada (the "Property"), from Fire Creek Lands, LLC (the "Optionor"). In consideration of the Option, the Company must make option payments in the aggregate amount of \$380,000 over a period of five years (US\$255,000 paid to date), and may purchase the Property on or before June 17, 2010 for \$2,500,000 with prior option payments being applied as a credit towards the purchase price.

The agreement was amended August 4, 2009. The amended consideration of the Option is as follows: the Company must make option payments in the aggregate amount of \$480,000 over a period of six years (US\$255,000 paid to date), and may purchase the Property on or before December 17, 2011 for \$2,500,000 with prior option payments being applied as a credit towards the purchase price.

In the event of the outright purchase of the Property by the Company, the Optionor will retain a 3% net smelter royalty, with the Company having a one-time option to purchase one percent of the royalty in consideration of \$1,000,000, at any time until June 17, 2015.

c) Maggie Creek, Elko County, Nevada

The Company has a 66.66% undivided interest in 48 claims (960 acres) situated in sections 8, 16 and 20 in the Maggie Creek area.

d) Hot Point Springs, Lander County, Nevada

The Company has a 100% ownership interest in 39 claims (780 acres) situated about 6 miles east of the town of Crescent Valley.

e) Reef claims, Churchill County, Nevada

The Company has a 100% ownership interest in 8 claims (160 acres) in the Fairchild District of Churchill County.

8. Asset Retirement Obligation

Included in the carrying value of the mineral properties is \$190,101 (US\$177,300) representing the estimated fair value of a liability for asset retirement obligations that arose as a result of drilling activities since fiscal 2004, on the Fire Creek properties. The fair value of the liability \$190,101 was determined to be equal to the estimated drill well site remediation costs as it is assumed that remediation would commence within six months of year end. As at September 30, 2009 the Company has not commenced development of any property and accordingly a reasonable estimate of the timing of the cash flows can not be made. As a result the expected cash costs have been recorded as a current liability.

In previous fiscal years, the Company has posted non-interest bearing bonds totalling \$190,101 (US\$177,300) with the Bureau of Land Management in the State of Nevada as security for these obligations. Fair value can not be reasonably determined and accordingly the bonds have been recorded at historical cost, adjusted for current exchange rates.

Klondex Mines Ltd.**Notes to the Interim Consolidated Financial Statements (Unaudited)**

September 30, 2009

9. Share Capitala) **Authorized:** unlimited common shares with no par valueb) **Issued**

	Shares	Amount	Contributed Surplus
Balance, December 31, 2007	22,989,673	\$ 27,009,163	\$ 2,233,225
Issued for cash			
Private placement @ \$1.15	1,520,000	1,748,000	-
Exercise of options	710,131	501,737	-
Fair value of options exercised	-	404,252	(404,252)
	2,230,131	2,653,989	(404,252)
Share issue costs			
Commission on private placement	-	(89,700)	-
Legal costs	-	(6,763)	-
	-	(96,463)	-
Stock based compensation	-	-	357,110
Increase (decrease) for the year	2,230,131	2,557,526	(47,142)
Balance, December 31, 2008	25,219,804	29,566,689	2,186,083
Issued for cash			
Private placement @ \$0.60	1,500,000	900,000	-
Commission on private placement	-	(41,400)	-
Legal fees	-	(10,612)	-
Private placement @ \$1.75	1,714,285	3,000,000	-
Commission on private placement	-	(120,000)	-
Legal & regulatory fees	-	(47,909)	-
Options exercised	740,000	705,250	-
Warrants exercised	1,790,000	2,605,000	-
Fair value of options exercised	-	462,350	(462,350)
Stock based compensation	-	-	854,148
Increase (decrease) for the period	5,744,285	7,452,679	391,798
Balance, September 30, 2009	30,964,089	\$ 37,019,368	\$ 2,577,881

On March 26, 2009, the Company announced that it had completed a non-brokered private placement of 1,500,000 units (the "Units") at a price of \$0.60 per unit for gross proceeds of \$900,000. Each Unit consists of one common share and one share purchase warrant. Each warrant will entitle the holder to purchase one additional common share of the Company at a price of \$0.90 for a period of 12 months after closing. The warrants are subject to a 30-day early expiration if the stock closes on the Toronto Stock Exchange, for a period of 20 consecutive trading days, at a price of \$1.30 or greater. A 5% commission that applied to a portion of the financing attributable to authorized agents in the amount of \$41,400 was paid.

Klondex Mines Ltd.**Notes to the Interim Consolidated Financial Statements (Unaudited)**

September 30, 2009

9. Share Capital (continued)**b) Issued**

Although the Company's shares traded at a price of \$1.30 or greater for 20 consecutive days, the Board of Directors decided not to call the early expiration of the warrants.

On June 30, 2009, the Company announced that it had completed a non-brokered private placement of 1,714,285 common shares at a price of \$1.75 per share for gross proceeds of \$3,000,000. A 5% commission that applied to a portion of the financing attributable to authorized agent in the amount of \$120,000 was paid.

c) Options outstanding

A summary of the Company's outstanding stock options as of September 30, 2009 and the changes during the periods then ended is presented below:

	Number of options	Weighted average exercise price
Outstanding and exercisable at December 31, 2007	2,130,131	\$ 1.52
Options granted	1,205,000	2.30
Options exercised	(710,131)	0.71
Options expired	(50,000)	0.65
Outstanding at December 31, 2008	2,575,000	1.52
Options granted (note 10)	950,000	1.00
Options exercised	(740,000)	0.95
Outstanding and exercisable at September 30, 2009	2,785,000	\$ 1.49

Number of Underlying Shares	Weighted average exercise price	Exercisable	Weighted average exercise price	Exercise Price	Expiry Date
160,000		160,000		\$ 1.05	June 10, 2010
645,000		645,000		\$ 2.35	July 17, 2011
150,000		150,000		\$ 2.30	January 19, 2012
200,000		200,000		\$ 2.25	May 7, 2012
105,000		105,000		\$ 2.30	January 21, 2013
775,000		775,000		\$ 0.86	September 17, 2013
750,000		750,000		\$ 1.00	March 2, 2014
2,785,000	\$ 1.49	2,785,000	\$ 1.49		

On June 15, 2009, the Company announced that it received a formal unsolicited offer from Silvercorp Metals Inc. ("Silvercorp") to acquire all of the outstanding shares of the Company for 0.5 of a common share of Silvercorp for each share of the Company. As a result of the unsolicited offer and in accordance with the stock option plan, all vesting provisions on outstanding stock options expired.

Klondex Mines Ltd.**Notes to the Interim Consolidated Financial Statements (Unaudited)**

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9. Share Capital (continued)**d) Warrants outstanding**

A summary of the Company's outstanding share purchase warrants at September 30, 2009 and the changes during the periods then ended is presented below:

	Number of warrants	Weighted average exercise price
Outstanding and exercisable at December 31, 2007	Nil	\$ Nil
Warrants granted, as per private placement	1,520,000	1.60
Outstanding and exercisable at December 31, 2008	1,520,000	1.60
Warrants granted, as per private placement	1,500,000	0.90
Warrants exercised	(1,790,000)	(1.46)
Warrants expired	(100,000)	(1.60)
Outstanding and exercisable at September 30, 2009	1,130,000	\$ 0.90

At September 30, 2009, there were 1,130,000 outstanding share purchase warrants entitling the holders thereof the right to purchase one common share for each warrant held as follows:

Number of Shares	Exercise Price	Expiry Date
1,130,000	\$ 0.90	March 26, 2010

10. Stock Based Compensation

The Company has adopted an incentive stock option plan (the "Plan"). The essential elements of the Plan provide that the aggregate number of common shares of the Company's capital stock issuable pursuant to options granted under the Plan may not exceed 15% of the number of issued shares of the Company at the time of the granting of the options. Options granted under the Plan will have a maximum term of ten years. The exercise price of options granted under the Plan will not be less than the discounted market price of the common shares (defined as the last closing market price of the Company's common shares immediately preceding the issuance of a news release announcing the granting of the options, less the maximum discount permitted under TSE policies), or such other price as may be agreed to by the Company and accepted by the TSE. According to the 2008 stock option plan, the vesting periods of options granted under the plan may vary at the discretion of the Plan Administrator, subject to Regulatory approval.

On March 2, 2009 the Company granted directors, officers and consultants 950,000 incentive stock options at an exercise price of \$1.00 per share expiring on March 2, 2014. Options have no vesting period imposed and are immediately exercisable.

On June 15, 2009, the Company announced that it received a formal unsolicited offer from Silvercorp to acquire all of the outstanding shares of the Company for 0.5 of a common share of Silvercorp for each share of the Company. As a result of the unsolicited offer and in accordance with the stock option plan, all vesting provisions on outstanding stock options expired.

The fair value of each option granted is estimated on the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions:

Klondex Mines Ltd.**Notes to the Interim Consolidated Financial Statements (Unaudited)**

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10. Stock Based Compensation (continued)

Date of grant 2009		02-Mar-09	Total or Average
Number of options		950,000	950,000
Number expected to vest		950,000	950,000
Estimated life		5 years	5 years
Share price at date of grant		\$0.63	\$0.63
Option exercise price		\$1.00	\$1.00
Risk free interest rate		2.5%	2.5%
Estimated volatility		84.44%	84.44%
Option fair value		\$0.37	\$0.37
Compensation cost		\$355,889	\$355,889

Date of grant 2008	22-Jan-08	17-Sep-08	Total or Average
Number of options	105,000	1,100,000	1,205,000
Number expected to vest	78,750	1,100,000	1,178,750
Estimated life	5 years	5 years	5 years
Share price at date of grant	\$2.15	\$0.89	\$1.00
Option exercise price	\$2.30	\$0.86	\$0.99
Risk free interest rate	3.75%	3.25%	3.29%
Estimated volatility	80.12%	70.52%	71.36%
Option fair value	\$1.40	\$0.54	\$0.62
Compensation cost	\$73,500	\$598,000	\$745,000

11. Non Cash Transactions

The following non-cash transactions were recorded during the period ended:

		September 30, 2009		December 31, 2008
Financing activities				
Contributed surplus allocated on exercise of options	\$	363,350	\$	404,252
Share capital allocated from contributed surplus	\$	(363,350)	\$	(404,252)

12. Financial Instruments**a) Currency risk**

Currency risk is the risk to the Company's earnings that arises from fluctuations of foreign exchange rates and the degree of volatility of these rates. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

Klondex Mines Ltd.**Notes to the Interim Consolidated Financial Statements (Unaudited)**

September 30, 2009

12. Financial Instruments (continued)**a) Currency risk** (continued)

At September 30, 2009 the Company had the following financial assets and liabilities:

		US Dollars
Cash	\$	1,898,443
Marketable securities	\$	205
Reclamation bonds	\$	177,300
Accounts payable	\$	158,528
Due to related parties	\$	69,701
Asset retirement obligation	\$	177,300

At September 30, 2009 US dollar amounts were converted at a rate of \$1.0722 Canadian dollars to \$1.00 US dollar.

b) Capital risk management

The Company includes cash and equity, comprising of issued common shares, contributed surplus and deficit, in the definition of capital.

The Company's objective when managing capital is to maintain its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders.

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition and exploration of mineral properties. The Board of Directors does not establish quantitative return on capital criteria for management but rather relies on the expertise of the Company's management and consultants to sustain future development of the business.

The Company's properties are in the exploration stage and as such the Company is dependent upon external financings to fund activities. In order to carry out planned exploration and pay for administrative costs, the Company will spend its existing working capital and raise the additional funds required.

Management reviews its capital management approach on an ongoing basis and believes that this approach is reasonable given the relative size of the Company.

There were no changes in the Company's approach to capital management during the period ended September 30, 2009. The Company is not subject to externally imposed capital requirements.

Klondex Mines Ltd.**Notes to the Interim Consolidated Financial Statements (Unaudited)**

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13. Related Party Transactions

The following transactions with related parties have been valued in these financial statements at the exchange amount, which is the amount of consideration established and agreed to by the parties:

- a) During the nine months ended September 30, 2009, the Company incurred consulting fees of \$36,000 (2008 - \$37,432) and capitalized mineral property services of \$114,100 (2008 - \$46,500) to companies controlled by each of an officer and a director, respectively.
- b) During the nine months ended September 30, 2009, the Company incurred salary and benefit expenses of \$128,574 (2008 - \$50,887) and rent of \$26,170 (2008 - \$Nil) to the President.
- c) During the nine months ended September 30, 2009, the Company incurred management fees of \$31,403 (2008 - \$27,347) and rent of \$5,234 (2008 - \$4,558) to a director.
- d) During the nine months ended September 30, 2009, the Company incurred accounting fees of \$63,641 (2008 - \$47,705) to an officer.
- e) During the nine months ended September 30, 2009, the Company incurred consulting fees of \$25,000 from directors and an officer directly related to the Silvercorp Metals Inc. unsolicited take-over bid.
- f) Amounts owing to directors and officers of \$116,286 (2008 - \$39,106) are non-interest bearing, unsecured, and payable upon demand. Fair value cannot be reliably determined.

14. Segmented Information

September 30, 2009	Canada	United States	Total
Interest earned	\$ 2,248	\$ -	\$ 2,248
Expenses	(1,541,336)	(433,235)	(1,974,571)
Loss for the period	\$ (1,539,088)	\$ (433,235)	\$ (1,972,323)
Identifiable assets	\$ 4,408,685	\$ 23,075,633	\$ 27,484,318
September 30, 2008	Canada	United States	Total
Interest earned	\$ 49,279	\$ -	\$ 49,279
Expenses	(448,032)	(274,562)	(722,594)
Loss for the period	\$ (398,753)	\$ (274,562)	\$ (673,315)
Identifiable assets	\$ 1,349,896	\$ 20,629,397	\$ 21,979,293

Klondex Mines Ltd.

Notes to the Interim Consolidated Financial Statements (Unaudited)

September 30, 2009

15. Commitments

As at September 30, 2009, the Company has shared lease commitments for office space expiring in February 2010. Minimum lease payments including estimated taxes and excluding operating costs for each of the next two years are as follows:

2009	\$ 4,010
<u>2010</u>	<u>2,005</u>
<u>Total</u>	<u>\$ 6,015</u>

As an inducement to enter into the new office space lease the landlord funded \$65,000 of leasehold improvements on behalf of the 4 tenants. The Company's share of these improvements has been capitalized and the resulting deferred leasehold inducements are recognized as a reduction of rent expense over the term of the lease.

16. Contingency

On July 20, 2009 the Company entered into a letter agreement (the "Letter Agreement") with Paramount Gold and Silver Corp. ("Paramount") setting out the principal terms upon which Paramount would acquire, pursuant to a plan of arrangement, all of the outstanding shares of the Company on the basis of 1.45 shares of the Paramount common stock for each of common share of the Company. On September 24, 2009, the Company terminated the Letter Agreement pursuant to its terms. The Company announced the termination in a news release on September 25, 2009. In its news release, the Company specified the reasons for the termination.

On September 30, 2009, Paramount commenced an action in the Supreme Court of British Columbia seeking payment of a break fee in the amount of US\$2.85 million, and unspecified damages for breach of contract, malicious falsehood and defamation. The Company denies that it has any liability to Paramount, and intends to mount an aggressive, vigorous defence against Paramount's claims. As of the date of this report, the Company's legal counsel is preparing the defence and counterclaim.

17. Subsequent Events

On October 6, 2009, the Company issued a press release asserting unequivocally that the letter agreement was terminated solely for the reasons set out in the Company's September 24, 2009 news release. The Company intends to mount an aggressive, vigorous defence of Paramount's claims and pursue a counterclaim for the reverse break free of US \$2.85 million plus damages. As of the date of this report, the Company's legal counsel is preparing the defence.

KLONDEX MINES LTD.

MANAGEMENT DISCUSSION & ANALYSIS

For the Nine Months Ended September 30, 2009

Directors and Officers as at November 12, 2009:

Directors:

William J. Solloway
Brendan Donohoe
Robert Sibthorpe
Ronald Shorr
Weiguo Lang

Officers:

President – William J. Solloway
Chief Financial Officer – Jorge Avelino
Secretary – Fred Baker

Contact Name:

Fred Baker
Telephone: (604) 638-3273
(604) 602-4935
Fax: (604) 602-4936

Toronto Stock Exchange Symbol:

KDX

KLONDEX MINES LTD.

MANAGEMENT DISCUSSION & ANALYSIS

For the Nine Months Ended September 30, 2009

1.1 Date of This Report

November 12, 2009

This MD&A includes certain statements that may be deemed “forward-looking statements”. All statements in this discussion, other than statements of historical facts, that address exploration drilling, exploitation activities and events or developments that the Company expects, are forward-looking statements. Although the Company believes the expectations expressed in such forward-looking statements are based on reasonable assumptions, such statements are not guarantees of future performance and actual results or developments may differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially from those in forward-looking statements include market prices, exploitation and exploration successes, continued availability of capital and financing and general economic, market or business conditions. Investors are cautioned that any such statements are not guarantees of future performance and actual results or developments may differ materially from those projected in the forward-looking statements.

1.2 Overall Performance

Description of Business

Klondex Mines Ltd. (“Klondex” or the “Company”) was founded in 1974 and is listed on the Toronto Stock Exchange under the symbol '[KDX](#)'. Klondex Mines is engaged in acquiring, exploring and developing gold and silver properties in Nevada.

Klondex holds mineral interests in the prime area of northern Nevada's mining industry. The Company's principal property is the 100% owned Fire Creek Property. The Fire Creek Property comprises leasehold land and fee land along the Northern Nevada Rift in North Central Nevada. It is strategically located in the Crescent Valley area of the Battle Mountain gold belt between the past producing Mule Canyon Mine to the north and the world-class Pipeline and Cortez gold deposits to the south.

1.3 Selected Annual Information

The highlights of financial data for the Company for the three most recently completed financial years are as follows:

	December 31, <u>2008</u>	December 31, <u>2007</u>	December 31, <u>2006</u>
(a) Total revenue	Nil	Nil	Nil
(b) Loss before extraordinary items			
(i) Total loss	\$1,154,138	\$1,252,259	\$1,470,080
(ii) Loss per share - basic	\$0.05	\$0.06	\$0.07
(iii) Loss per share - diluted	\$0.05	\$0.06	\$0.07
(c) Net loss			
(i) Total loss	\$1,154,138	\$1,252,259	\$1,470,080
(ii) Loss per share - basic	\$0.05	\$0.06	\$0.07
(iii) Loss per share - diluted	\$0.05	\$0.06	\$0.07
(d) Total assets	\$23,430,737	\$20,366,135	\$19,991,957
(e) Total long-term liabilities	\$4,113	\$7,388	\$10,663
(f) Cash dividends declared per-share	N/A	N/A	N/A

1.4 Results of Operations

Discussion of Acquisitions, Operations and Financial Condition

The following should be read in conjunction with the financial statements of the Company and notes attached hereto.

NEVADA MINERAL PROPERTIES

Acquisition and Exploration expenditures:

Nevada Properties	September 30, 2009	December 31, 2008
Balance, beginning of the period	\$ 21,282,764	\$ 15,769,182
Acquisition of land	53,610	297,560
Advance - Drilling	107,220	(99,293)
Assays and core costs	64,221	549,046
Consulting - geological	282,345	363,745
Drilling	648,962	3,767,091
Environmental consulting & permitting	29,275	282,918
Field supplies and equipment	44,142	155,337
Geophysics	112,879	31,123
Lease payments, taxes and royalties	22,517	17,944
Legal	345	1,915
Maintenance fees	95,209	75,351
Mapping and sampling	785	520
Miscellaneous	40,883	57,026
Site visits	22,453	13,299
Current expenditures for the period	1,524,846	5,513,582
Balance, end of period	\$ 22,807,610	\$ 21,282,764

1.4 Results of Operations (continued)

Fire Creek Gold Properties, Lander County, Nevada

The Company has a 100% ownership interest in this land block which was expanded during fiscal 2003 by 2,720 acres to a total of 4,875 acres. During fiscal 2004, the Company acquired four additional blocks of land (80 acres) in the area for Cdn\$69,567 (US\$52,983). During fiscal 2006, the Company acquired additional blocks of land, which totaled 130 acres for Cdn\$119,030 (US\$97,009). These acquisitions were necessary to ensure logistical access to the main mineralized zones and to acquire areas which represent the strike extensions of these zones. During the year ended December 31, 2007, the Company acquired an additional 50 acres for \$70,433 (US\$66,490).

During the year ended December 31, 2008, the Company acquired an additional 400 acres for \$184,504 (US\$182,475). The Company includes the Woodtick and Corral Canyon claims in the greater Fire Creek Project area. The total unpatented claims within the project area now total 484 claims, or 9,680 acres and fee lands now total 1,428 acres.

Corral Canyon, Lander County, Nevada

The Company has a 100% ownership interest in 42 claims (840 acres) in Corral Canyon, Lander County, Nevada. The claims are in good standing and were renewed on September 1, 2009. These claims were added to the Fire Creek project in fiscal 2007 and are included in the Fire Creek discussion.

Woodtick claims, Lander County, Nevada

The Company has a 100% ownership interest in these 26 claims (520 acres). They lie directly north-east of Fire Creek along the Mule Canyon-Fire Creek-Buckhorn volcanic trend. These claims provide access to the northern Fire Creek block from the powerline road. The claims are in good standing and were renewed on September 1, 2009. These claims were added to the Fire Creek project in fiscal 2007 and are included in the Fire Creek discussion.

Exploration Results and Future Plans & Developments

On March 2, 2009, the Company announced the assays from the final 15 holes of its 2008 drill program. The holes continued the program of drilling untested geophysical anomalies and extending known resource zones. These drill holes were incorporated in an NI 43-101-compliant resource update for its 100%-owned Fire Creek high-grade gold property, which was filed on SEDAR on March 31, 2009.

On April 1, 2009, the Company announced that it had received an NI 43-101-compliant update report on its 100%-owned Fire Creek gold property in the Battle Mountain-Eureka Trend in Northern Nevada which contains the following information:

“Through extensive drill campaigns carried out over the past 5 years Klondex has defined an Indicated Mineral Resource estimated at 5,043,033 metric tons averaging 10.11 grams per metric ton (gpt) for 1,639,822 ounces of gold equivalent with an average interval true width of 5.5 meters using a cut-off grade of 5.0 gpt. This cut-off grade also resulted in an inferred resource estimate of 1,833,423 metric tons tonnes grading 8.63 gpt for 508,799 ounces of gold.”

1.4 Results of Operations (continued)

Fire Creek Gold Properties, Lander County, Nevada

The current mineral resource figures at various cut-off grades are presented in the table below and all represent a significant increase in tonnage and contained gold over the September 2006 resource estimate of an indicated resource of 1,636,555 tonnes grading 19.88 gpt containing 1,045,738 ounces of gold.

Fire Creek Project - Indicated and Inferred Resource

Gold Cut-off GPT	Classification	Metric Tons	Grade GPT	Oz. Gold*
8.0	Indicated	2,408,299	16.42	1,271,392
8.0	Inferred	1,074,308	13.57	468,856
5.0	Indicated	5,043,033	10.11	1,639,822
5.0	Inferred	1,833,423	8.63	508,799
2.0	Indicated	14,056,610	4.67	2,111,002
2.0	Inferred	8,877,720	3.74	1,068,488

* Gold equivalent with silver at 60:1

This Mineral Resource Update was based on information from an additional 101 drill holes totaling 147,110 feet (44,837 meters) received between August 2006 and December 2008. The estimation method used was the polygonal technique. Key assumptions included an average mining width of 5.5 meters (for the 5.0 gpt cut off estimate) for dilution and a bulk tonnage factor of 2.55 was applied based on specific gravity measurements of representative core. High gold values were not cut but their area of influence was limited by a number of constraints. The Mineral Resource Update reflects three different mineral cutoffs. The September 2006 mineral resource was based on a cutoff of 10 gpt and an average mining width of less than 3 meters. The reduced GPT cutoffs and increased mining widths utilized in the Mineral Resource Update were deemed appropriate given the significant increase in the price of gold over the past 2 ½ years. The silver to gold grade ratio is approximately 1:1 and silver does not have a significant economic impact on the overall resource at Fire Creek but is important locally within the zones.

On July 9, 2009, the Company announced that it had resumed surface drilling on the Fire Creek Project. The drilling, part of the program recommended in the Company's March 2009 NI 43-101-compliant resource update, will further test the two high-grade gold vein sets which make up the Main Zone and which are primary targets for Klondex's planned bulk sampling initiative. Later this month Klondex anticipates the grant of permits by the U.S. Bureau of Land Management which will allow initiation of underground exploration.

Initially, five holes totaling 1,890 meters (6,200 feet) will be drilled to test high-grade zones on the two north-northwest striking gold-bearing structures which make up the Main Zone. The holes are intended to confirm above average grades reported in previous drill intercepts as well as to demonstrate continuity in these locations.

1.4 Results of Operations (continued)

Fire Creek Gold Properties, Lander County, Nevada

Discussion of Drilling Targets:

Two proposed holes (P1 and P5 as shown on the accompanying map) will test the Main Zone along the 350m and 400m North profiles in the Main Zone. Proposed hole P1 will test the hole FC0417 intercept grading 95.2 gpt (grams per metric ton) gold and 53.5 gpt silver over an estimated true width* of 3.81 meters (including 411 gpt gold and 236.0 gpt silver over 0.76 meters) and the intercept from FC0512 grading 16.8 gpt gold and 54.4 gpt silver over 2.66 m on Vein M2. This hole will also test for the up dip extension of the intercept reported in FC0513 of 40.1 gpt gold and 105.4 gpt silver over 2.66 m on Vein M1. Proposed hole P5 will be drilled 50 meters to the north of P1 and will test the intercepts from FC0403 (30.3 gpt gold and 21.8 gpt silver over 2.44 m) and FC0502 (20.8 gpt gold and 19.5 gpt silver over 6.1 m), both on Vein M1.

Some 200 to 250 meters to the south, a set of three proposed holes (P2, P3 and P4) will test the high grade area on Vein M1 characterized by previously reported high-grade intercepts such as FC0413 (182.5 gpt gold and 156.0 gpt silver over 1.22m), FC0621 (24.6 gpt gold and 16.2 gpt silver over 8.54m), FC0419 (14.2 gpt gold and 14.0 gpt silver including 76.0 gpt gold and 76.9 gpt silver over 2.44m) and FC0619 (30.1 gpt gold and 24.3 gpt silver over 6.1m, 60.9 gpt gold and 31.5 gpt silver over 2.8m and 64.2 gpt gold and 30.5 gpt silver over 1.2m).

*All widths reported above are true widths generally estimated to be 50-80% of reported widths.

As of September 30, 2009, infill drilling at the Main Zone was completed and the Company began stepout drilling to enlarge the resource. Seven holes totalling 7,701 feet were completed.

Lander & Eureka Counties, Nevada

The Company has an option to acquire a 100% interest (the "Option") in certain lands located in Lander & Eureka Counties, Nevada (the "Property"), from Fire Creek Lands, LLC (the "Optionor"). The Property has the potential for copper, silver, gold and other valuable mineral deposits. In consideration of the Option, the Company must make option payments in the aggregate amount of \$380,000 over a period of five years (US\$255,000 paid to date), and may purchase the Property on or before June 17, 2010 for \$2,500,000 with prior option payments being applied as a credit towards the purchase price.

The agreement was amended August 4, 2009. The amended consideration of the Option is as follows: the Company must make option payments in the aggregate amount of \$480,000 over a period of six years (US\$255,000 paid to date), and may purchase the Property on or before December 17, 2011 for \$2,500,000 with prior option payments being applied as a credit towards the purchase price.

In the event of an outright purchase of the Property by the Company, the Optionor will retain a 3% net smelter royalty, with the Company having a one-time option to purchase one percent of the royalty in consideration of \$1,000,000, at any time until June 17, 2015.

The Company has a 100% ownership interest in 8 claims (160 acres) in the Fairchild District of Churchill County. Anomalous gold and silver were previously detected along a siliceous reef which runs approximately a half mile in length. The claims are in good standing and were renewed on September 1, 2009. The property is subject to U.S. federal and state environmental statutes. No future work is planned for the property at this time.

1.4 Results of Operations (continued)

Maggie Creek, Elko County, Nevada

The Company has a 66.66% undivided interest in 48 claims (960 acres) situated in sections 8, 16 and 20 in the Maggie Creek area in Elko County, Nevada. The claims are in good standing and were renewed on September 1, 2009. The property is subject to U.S. federal and state environmental statutes. No future work is planned for the property at this time. The claims are being held due to their strategic location.

Reef claims, Churchill County, Nevada

The Company has a 100% ownership interest in 8 claims (160 acres) in the Fairchild District of Churchill County. Anomalous gold and silver were previously detected along a siliceous reef which runs approximately a half mile in length. The claims are in good standing and were renewed on September 1, 2009. The property is subject to U.S. federal and state environmental statutes. No future work is planned for the property at this time.

Hot Springs Point, Lander County, Nevada

The Company has a 100% ownership interest in 39 claims (780 acres) situated about 6 miles east of the town of Crescent Valley. They are in a basalt-andersite setting. The claims are in good standing and were renewed on September 1, 2009.

Discussion of Operations and Financial Condition

Results of Operations

Interest income for the nine months ended September 30, 2009 was \$2,248 compared to \$49,279 for the nine months ended September 30, 2008. The loss for the nine months ended September 30, 2009 was \$1,972,323 as compared with a loss of \$673,315 for the nine months ended September 30, 2008.

The increase in the loss for the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008 is related to the following:

- Stock-based compensation increased by \$670,478 during the nine months ended September 30, 2009. As a result of the unsolicited take-over bid from Silver Corp Metals and in accordance with the stock option plan, all vesting provisions in outstanding stock options expired. The Company expensed \$312,717 as stock-based compensation during the second quarter and \$Nil in the third quarter.
- Office and general expenses increased by \$41,256 during the nine months ended September 30, 2009. Included in this amount are interest expense and bank charges of \$33,192. The Company incurred \$18,258 in interest due to an overdraft in the US\$ brokerage account with Jones Gable. In addition, the Company incurred interest expense of \$9,085 from several US suppliers for unpaid drilling bills.
- Consulting fees and Legal and Accounting fees increased by \$117,956 and \$350,786 respectively. This was a result of the Company's efforts in responding to the unsolicited take-over bid by Silver Corp Metals and the Paramount business combination letter agreement.

1.4 Results of Operations (continued)

Discussion of Operations and Financial Condition (continued)

A breakdown of the “Consulting Fees” expense is as follows:

Corporate & administration fees	\$	14,606
Shareholders communication (Canada)		42,250
Shareholders communication (USA)		37,870
Fees directly related to the Silvercorp take-over bid and Paramount business combination		119,852
Total	\$	214,578

A breakdown of the “Travel, accommodation and meetings” expense is as follows:

Travel	\$	50,561
Communication, Conference and meetings		50,428
Meals & entertainment		10,305
Total	\$	111,294

Investor Relations Activities

During the period, the Company responded to investor inquiries and conducted shareholder and investor mailouts. The responsibility for responding directly to all investor inquiries and for conducting shareholder and investor mailouts is handled by the Corporate Secretary in Vancouver and by the 2 directors in New York.

In January 2007, the Company entered into a one year agreement with Jaffoni & Collins (“JCI”) to provide investor relations services for the Company (automatically renews for successive one year periods). Founded in 1994, JCI (www.jcir.com) is a full-service investor relations agency exclusively focused on creating and executing communication programs for public companies. JCI will be responsible for developing and implementing, and advising the Company with respect to investor relations and financial policies and opportunities. JCI is based in New York, New York and works closely with institutional investors, sell-side analysts, brokers, and private investors and the media in Canada and the United States. JCI and its principals are at arm’s length to the Company.

JCI’s monthly fee is US\$5,000 plus expenses related to dissemination of information. JCI currently has stock options of 150,000 at \$2.30 per share, 25,000 at \$0.86 per share and 25,000 @ \$1.00 per share.

Financings, Principal Purposes & Milestones

On March 27, 2009, the Company announced that it had completed a non-brokered private placement of 1,500,000 units (the “Units”) at a price of \$0.60 per unit for gross proceeds of \$900,000. Each Unit consisted of one common share and one share purchase warrant. Each warrant entitles the holder to purchase one additional common share of the Company at a price of \$0.90 for a period for 12 months after closing. The warrants are subject to a 30-day early expiration if the stock closes on the Toronto Stock Exchange, for a period of 20 consecutive trading days, at a price of \$1.30 or greater. A 5% commission (\$41,400) was paid to authorized agents.

Financings, Principal Purposes & Milestones (continued)

On June 30, 2009, the Company announced that it had completed a non-brokered private placement of 1,714,285 common shares at a price of \$1.75 per share for gross proceeds of \$3,000,000. A 5% commission that applied to a portion of the financing attributable to authorized agent in the amount of \$120,000 was paid.

For a discussion on “Principal Purposes & Milestones”, please refer to the detailed discussion on the Fire Creek Property.

On July 20, 2009, the Company announced that it had entered into a binding letter of agreement with Paramount Gold and Silver Corp. (“Paramount”) to combine the two companies under a plan of arrangement in a transaction valued at approximately C\$80 million (the “Transaction” or the “Paramount Transaction”). The Letter Agreement was unanimously approved by the Board of Directors of both Companies.

Pursuant to the Letter Agreement, each Klondex share would have been exchanged for 1.45 Paramount shares, implying a purchase price of C\$2.32 per Klondex share using closing share prices on the TSX on July 17, 2009. The Transaction represented a premium of 33.3% to the closing price of Klondex shares and a 30.3% premium to the implied value of the unsolicited proposal by Silvercorp Metals Inc. (“Silvercorp.”) as of July 17, 2009. The Silvercorp proposal was announced on June 8, 2009, and was rejected by the Klondex Board of Directors as providing inadequate consideration for Klondex shareholders.

On September 24, 2009, the Company announced that it had terminated the July 20, 2009 letter agreement (the “Letter Agreement”) with Paramount Gold and Silver Corp. (“Paramount”) in respect of a proposed business combination of Klondex and Paramount. The Letter Agreement was terminated by the Company in accordance with its terms. As a result of Paramount’s breach of the terms of the Letter Agreement, the Company believes it is entitled to a reverse break fee of US\$2.85 million plus damages and denies it has any obligation to pay Paramount any break fee.

The Company’s decision to terminate the agreement was based on the results of its due diligence which revealed that Paramount’s public disclosure record contained material misstatements and omissions regarding the inferred resource at Paramount’s San Miguel Project in Mexico. The Company believes that these misrepresentations have a material adverse affect on the value and potential of the San Miguel Project. The Company formally advised Paramount of the misrepresentations on September 13, 2009.

On Friday, September 18, 2009, after notice from the Company of its due diligence review of the San Miguel Project, Paramount made publicly available only on SEDAR an updated 83 page technical report in respect of the San Miguel Project dated September 15, 2009 (the “New Report”). After review of the New Report, the Company concluded that the New Report confirms the results of its due diligence investigation and provides first time public disclosure that a significant portion of the newly identified higher grade mineralized material located in Clavo 66 and Clavo 99 of the San Miguel Project resource (the “San Miguel Resource”) is actually located on a neighbouring property, in which Paramount has no known ownership rights. The Company has been unable to confirm the amount of the higher-grade mineralization located on the neighboring property as Paramount has refused to provide to Klondex the underlying data used to calculate the San Miguel Resource. The Company believes that the amount of mineralization in question is significant.

Financings, Principal Purposes & Milestones (continued)

From its review of the New Report, the Company also determined that, although the resource reported in Clavos 66 and 99 is open to depth, a portion of the resource that is open to depth is actually located on the neighbouring property, in which Paramount has no known ownership rights. Klondex is of the view that this materially limits the prospects for the San Miguel Project.

The foregoing information was not publicly available and not readily apparent from the public record at the time the Company entered into the Letter Agreement. The public record at that time made no reference to claim boundaries in relation to the mineralized zones at Clavos 66 and 99 and consistently referred to these zones as being open to depth. The Company only became aware of the discrepancy after completing a site visit and interviewing members of Paramount's personnel.

On September 30, 2009, Paramount commenced an action in the Supreme Court of British Columbia seeking payment of a break fee in the amount of US\$2.85 million, and unspecified damages for breach of contract, malicious falsehood and defamation. The Company denies that it has any liability to Paramount, and intends to mount an aggressive, vigorous defence against Paramount's claims. As of the date of this report, the Company's legal counsel is preparing the defence and counterclaim.

On October 6, 2009, the Company issued a press release asserting unequivocally that the letter agreement was terminated solely for the reasons set out in the Company's September 24, 2009 news release. The Company intends to mount an aggressive, vigorous defense of Paramount's claims and pursue a counterclaim for the reverse break free of US \$2.85 million plus damages. As of the date of this report, the Company's legal counsel is preparing the defence.

1.5 Summary of Quarterly Results

The following is a summary of the Company's financial results for the eight most recently completed quarters:

	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
	Sep-09	Jun-09	Mar-09	Dec-08	Sep-08	Jun-08	Mar-08	Dec-07
Total loss	(531,358)	(649,424)	(791,541)	(480,823)	(199,354)	(269,448)	(204,513)	(417,092)
Per share	(\$0.02)	(\$0.02)	(\$0.03)	(\$0.02)	(\$0.01)	(\$0.01)	(\$0.01)	(\$0.02)

Discussion

For a detailed discussion on the nine months ended September 30, 2009, please refer to Section 1.4 - Results of Operations.

1.6 Liquidity

The Company has no revenue generating projects at this time. The Company's historical capital needs have been met by equity subscriptions. As at September 30, 2009, the Company had a working capital of \$3,810,122 (December 31, 2008 – working capital deficit of \$575,562). The Company currently has sufficient working capital for general and administration expenses. The Company will require capital to meet the exploration program for the Fire Creek property. However, this is a forward-looking statement as it involves known and unknown risks, uncertainties and other factors, which could affect the actual results, performance or achievements of the Company and impact on the adequacy of working capital required for the year 2009 and 2010 expressed by such forward-looking statement. Also, the ability of the Company to continue with recommended exploration programs on its current properties, and/or to successfully acquire and develop additional properties in the resource sector is conditional on its ability to secure financing when required. The Company proposes to meet any additional financing requirements through the exercise of outstanding stock options and warrants, or arranging other equity financing, and/or finalizing a joint venture agreement with a partner(s) who will be able to assume the costs of recommended exploration programs. In light of the continually changing financial markets, there is no assurance that funding by equity subscriptions or finding a joint venture partner will be possible at the times required or desired by the Company.

Currency Risk

Currency risk is the risk to the Company's earnings that arises from fluctuations of foreign exchange rates and the degree of volatility of these rates. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

At September 30, 2009 the Company had the following financial assets and liabilities:

	US Dollars
Cash	\$ 1,898,443
Marketable securities	\$ 205
Reclamation bonds	\$ 177,300
Accounts payable	\$ 158,528
Due to related parties	\$ 69,701
Asset retirement obligation	\$ 177,300

At September 30, 2009 US dollar amounts were converted at a rate of \$1.0722 Canadian dollars to \$1.00 US dollar.

Capital risk management

The Company includes cash and equity, comprising of issued common shares, contributed surplus and deficit, in the definition of capital.

The Company's objectives when managing capital is to maintain its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders.

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition and exploration of mineral properties. The Board of Directors does not establish quantitative return on capital criteria for management but rather relies on the expertise of the Company's management and consultants to sustain future development of the business.

1.6 **Liquidity** (continued)

The Company's properties are in the exploration state and as such the Company is dependent upon external financings to fund activities. In order to carry out planned exploration and pay for administrative costs, the Company will spend its existing working capital and raise the additional funds required.

Management reviews its capital management approach on an ongoing basis and believes that this approach is reasonable given the relative size of the Company.

There were no changes in the Company's approach to capital management during the nine months ended September 30, 2009. The Company is not subject to externally imposed capital requirements.

1.7 **Capital Resources**

The only capital resources of the Company are its mineral properties with a historical cost of \$22,807,610 and its property and equipment with a net book value of \$23,484.

1.8 **Off Balance Sheet Arrangements**

There are no off-balance sheet arrangements to which the Company is committed.

1.9 **Transactions with Related Parties**

The Financial Statements attached hereto provide disclosure on related party transactions for the nine months ended September 30, 2009, with breakdown as follows:

Expense	30-Sep-09	30-Sep-08
Management salaries & fees	\$ 159,977	\$ 78,234
Consulting fees:		
- Shareholders communication	36,000	37,432
- Related to take-over bid	25,000	-
Accounting fees	63,641	47,705
Rent	31,402	4,558
Deferred geological fees	114,100	46,500
Total for the period	\$ 430,121	\$ 214,429

Amounts due to directors and officers of \$116,286 (2008 - \$39,106) are non-interest bearing, unsecured, and payable upon demand.

1.10 **Third Quarter – 2009:**

The second quarter expenditures do not differ significantly from other quarters and were in the normal course of the business with exception of the increased accounting, consulting and legal fees directly related to Silvercorp take-over-bid and the Paramount business combination.

1.11 **Proposed Transactions**

None

1.12 Critical Accounting Estimates

In preparing financial statements, management has to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Based on historical experience, current conditions and expert advice, management makes assumptions that are believed to be reasonable under the circumstances. These estimates and assumptions form the basis for judgments about the carrying value of assets and liabilities and reported amounts for revenues and expenses. Different assumptions would result in different estimates and actual results may differ from results based on these estimates. These estimates and assumptions are also affected by management's application of accounting policies. Critical accounting estimates are those that affect the consolidated financial statements materially and involve a significant level of judgment by management. Please refer to Note 2 of the Annual Financial Statements.

1.13 Changes in Accounting Policies

Please refer to Note 2 of the Financial Statements.

1.14 Financial and Other Instruments

The carrying value of cash and cash equivalents, marketable securities, accounts receivable, brokerage account overdraft, accounts payable and due from (to) related parties approximate their fair values due to the short maturity of those instruments.

1.15 Other

1.15.1 Share Capital

Disclosure of Outstanding Share Capital (November 12, 2009)

	Number	Book Value	Contributed Surplus
Common Shares	30,964,089	\$37,019,364	\$2,577,881

Summary of incentive stock options: (November 12, 2009)

Number of Shares	Expiry Date	Exercise Price
160,000	June 10, 2010	\$1.05
645,000	July 17, 2011	\$2.35
150,000	January 19, 2012	\$2.30
200,000	May 7, 2012	\$2.25
105,000	January 21, 2013	\$2.30
775,000	September 17, 2013	\$0.86
750,000	March 2, 2014	\$1.00
2,785,000		

Summary of warrants outstanding: (November 12, 2009)

Number of Shares	Expiry Date	Exercise Price
1,130,000	March 26, 2010	\$0.90
1,130,000		

1.15.2 Disclosure Controls and Procedures

The Company has disclosure controls and procedures in place to provide reasonable assurance that any information required to be disclosed by the Company under securities legislation is recorded, processed, summarized and reported within the applicable time periods and to ensure that required information is gathered and communicated to the Company's management so that decisions can be made about timely disclosure of that information. The Company's Chief Executive Officer and Chief Financial Officer evaluated the Company's disclosure controls and procedures for the nine months ended September 30, 2009. Management and the Board have found those disclosure controls and procedures to be adequate for the above purposes.

Internal Controls over Financial Reporting

The Chief Executive Officer, the Chief Financial Officer and the Audit Committee of the Company are responsible for designing a system of internal controls over financial reporting, or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with Canadian generally accepted accounting principles. The Chief Executive Officer, the Chief Financial Officer and the Audit Committee have designed and implemented a system of internal controls over financial reporting which they believe is effective for the Company. During the review of the design of the Company's control system over financial reporting it was noted that due to the limited number of staff, there is an inherent weakness in the system of internal controls due to our inability to achieve appropriate segregation of duties. The limited number of staff may also result in identifying weaknesses with respect to accounting for complex and non-routine transactions due to a lack of technical resources, and a lack of controls governing our computer systems and applications within the Company. While management of the Company has put in place certain procedures to mitigate the risk of material misstatement in the Company's financial reporting, it is not possible to provide absolute assurance that this risk can be eliminated.

1.15.4 Subsequent Event

On October 12, 2009, the Company announced the appointment of Dr. Weiguo Lang, age 51, to the company's Board of Directors. Dr. Lang's appointment returns the Company's board size to five members.

1.15.5 Additional information

Additional information relating to the Company is on SEDAR at www.sedar.com.