

**CANADA RARE EARTHS INC.**  
(An Exploration Stage Company)

**Condensed Interim Financial Statements  
For the Nine Months Ended  
October 31, 2011**

**(Unaudited)**

**Notice of No Auditor Review of Condensed Interim Financial Statements**

The accompanying unaudited condensed interim financial statements have been prepared by management and approved by the Audit Committee.

The Company's independent auditors have not performed a review of these financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of condensed interim financial statements by an entity's auditors.

December 16, 2011

**CANADA RARE EARTHS INC.**  
**Condensed Interim Statement of Financial Position**  
**(Unaudited – Expressed in Canadian Dollars)**

	October 31, 2011	January 31, 2011	February 1, 2010
<b>Assets</b>			
<b>Current</b>			
Cash	\$ 1,020,529	\$ 96,503	\$ 2,609
Amounts receivable	116,739	4,649	-
Prepaid expenses	10,000		
Marketable securities (note 4)	26,800	55,404	-
Discontinued Operations - accounts receivable	-	-	30,833
	1,174,068	156,556	33,442
<b>Exploration and Evaluation Assets</b> (note 6)	1,136,871	190,000	-
<b>Property and Equipment</b> (note 5)	102,341	75,673	75,617
<b>Discontinued Operations - Cost of Property and Equipment Held for Sale</b>	-	-	224,693
	\$ 2,413,280	\$ 422,229	\$ 333,752
<b>Liabilities</b>			
<b>Current</b>			
Accounts payable and accrued liabilities (note 7)	\$ 14,249	\$ 56,410	\$ 132,582
Due to related parties (note 9)	-	-	248,563
	14,249	56,410	381,145
<b>Discontinued Operations – Asset Retirement Obligations</b>	-	-	4,707
	14,249	56,410	385,852
<b>Shareholders' Equity</b>			
<b>Share Capital</b> (note 10)	26,301,898	23,553,245	23,104,130
<b>Share Compensation Reserves</b> (note 10(f))	1,887,653	1,666,199	1,544,809
<b>Shares Subscriptions Received</b>	-	34,800	-
<b>Deficit</b>	(25,790,520)	(24,888,425)	(24,701,039)
	2,399,031	365,819	(52,100)
	\$ 2,413,280	\$ 422,229	\$ 333,752

Subsequent Events (note 14)

Approved on behalf of the Board:

*“David McMillan”*

..... Director  
David McMillan

*“Chad McMillan”*

..... Director  
Chad McMillan

See notes to condensed interim financial statements

**CANADA RARE EARTHS INC.**  
**Condensed Interim Statements of Comprehensive Loss**  
**(Unaudited – Expressed in Canadian Dollars)**  
**For the periods ended October 31, 2011 and 2010**

	9 Months Ended October 31, 2011	9 Months Ended October 31, 2010	3 Months Ended October 31, 2011	3 Months Ended October 31, 2010
<b>General and Administrative Expenses</b>				
Accounting, audit and legal fees	\$ 67,225	41,726	\$ 26,548	\$ 3,829
Amortization and accretion	-	9,091	-	-
Consulting fees	78,724	47,431	20,297	8,663
Communications	8,188	953	4,440	340
Interest and bank charges	1,185	21,867	454	1,675
Insurance	12,197	-	-	-
Investor relations and promotions	166,000	-	55,973	-
Management fees (note 9(c),(g))	93,000	(23,692)	32,500	7,500
Office and administrative	148,914	6,933	72,333	474
Rent	41,273	(2,178)	12,646	-
Stock-based payments (note 10(e))	221,454	-	-	-
Transfer agent, listing and filing fees	43,133	25,425	5,238	6,444
Travel and entertainment	49,277	8,764	25,879	5,725
<b>Loss before other items</b>	<b>930,570</b>	<b>136,320</b>	<b>256,308</b>	<b>34,650</b>
Other Items				
Gain on disposition of gas property (note 13)	-	(134,398)	-	-
Unrealized gain on marketable securities	14,400	-	(600)	-
Realized gain on marketable securities	12,829	-	3,485	-
	27,229	(134,398)	2,885	-
<b>Income (Loss) from continued operations</b>	<b>(903,341)</b>	<b>(1,922)</b>	<b>(253,423)</b>	<b>(34,650)</b>
Income (Loss) from Discontinued Operations (note 13)	1,246	2,419	-	-
<b>Net Income (Loss) and Comprehensive Loss for Period</b>	<b>(902,095)</b>	<b>497</b>	<b>(253,423)</b>	<b>(34,650)</b>
<b>Deficit - beginning of period</b>	<b>24,888,424</b>	<b>24,701,039</b>	<b>25,537,097</b>	<b>24,665,893</b>
<b>Deficit - end of period</b>	<b>\$ 25,790,520</b>	<b>\$ 24,700,543</b>	<b>\$ 25,790,520</b>	<b>\$ 24,700,543</b>
<b>Weighted average number of shares outstanding – Basic and Diluted</b>	<b>14,770,402</b>	<b>8,921,675</b>	<b>14,770,402</b>	<b>9,671,275</b>
<b>Net loss per share - basic and diluted</b>	<b>\$ 0.06</b>	<b>\$ 0.001</b>	<b>\$ 0.02</b>	<b>\$ 0.004</b>

**CANADA RARE EARTHS INC.**  
**Condensed Interim Statements of Cash Flows**  
**(Unaudited – Expressed in Canadian Dollars)**  
**Nine Month Periods Ended October 31**

	9 Months Ended October 31, 2011	9 Months Ended October 31, 2010	3 Months Ended October 31, 2011	3 Months Ended October 31, 2010
<b>Operating Activities</b>				
Net gain (loss) for the period	\$ (902,095)	\$ 497	\$ (253,423)	\$ (34,649)
Items not involving cash				
Amortization, depletion and accretion	-	9,091	-	-
Stock-based payments	221,454	-	-	-
Realized gain on marketable securities	(12,829)	-	(3,485)	-
Unrealized gain on marketable securities	(14,400)	-	600	-
Gain on disposition of gas property (note 13)	-	(134,398)	-	-
Interest on short term loan	-	20,000	-	-
	<b>(707,870)</b>	<b>(104,810)</b>	<b>(256,308)</b>	<b>(34,649)</b>
Changes in non-cash working capital				
Accounts receivable	(112,090)	16,153	(78,990)	3,940
Accounts payable and accrued liabilities	(42,161)	(114,422)	(1,346)	(34,490)
Prepaid expense	(10,000)	-	50,396	38
<b>Cash Used in Operating Activities</b>	<b>(872,121)</b>	<b>(203,079)</b>	<b>(286,248)</b>	<b>(65,161)</b>
<b>Investing Activities</b>				
Proceeds from sale of marketable securities	55,834	-	6,585	-
Expenditures on furniture and equipment	(26,668)	-	(15,668)	-
Exploration costs deferred – resource properties	(946,871)	-	(706,454)	-
Disposition of gas property (note 13)	-	300,000	-	-
Exploration costs deferred- oil and gas interests	-	(1,149)	-	-
<b>Cash Used in Investing Activities</b>	<b>(917,705)</b>	<b>298,851</b>	<b>(715,537)</b>	<b>-</b>
<b>Financing Activities</b>				
Issuance of shares for cash, net of issuance costs	2,563,153	-	47,000	-
Issuance of shares for property	185,500	-	185,500	-
Due to related parties	-	(84,448)	-	(47,683)
Obligation to issue shares	(34,800)	-	-	-
Proceeds from short-term loans (note 9(f))	-	100,000	-	-
<b>Cash Provided by Financing Activities</b>	<b>2,713,853</b>	<b>15,552</b>	<b>232,500</b>	<b>(47,683)</b>
<b>Increase (Decrease) in Cash</b>	<b>924,027</b>	<b>111,324</b>	<b>(769,285)</b>	<b>(112,844)</b>
<b>Cash, Beginning of Period</b>	<b>96,503</b>	<b>2,610</b>	<b>1,789,814</b>	<b>226,778</b>
<b>Cash, End of Period</b>	<b>\$ 1,020,529</b>	<b>\$ 113,934</b>	<b>\$ 1,020,529</b>	<b>\$ 113,934</b>

**CANADA RARE EARTHS INC.**

**Condensed Interim Statements of Equity**

**(Unaudited – Expressed in Canadian Dollars)**

	Common Shares			Accumulated Deficit	Accumulated Other Comprehensive Income	Share Subscriptions Received	Total
	Number of Shares	Amount	Reserve				
Balances February 1, 2010	25,331,522	\$23,104,130	\$1,544,809	\$(24,701,039)	\$ -	\$ -	\$(52,100)
Shares issued for debt	3,282,303	164,115					164,115
Short-term loan agreements – financing fee	400,000	20,000					20,000
Fair value adjustments					5,699		5,699
Net gain				497			497
<b>Balances October 31, 2010</b>	<b>29,013,825</b>	<b>\$23,288,245</b>	<b>\$1,544,809</b>	<b>\$(24,700,542)</b>	<b>\$ 5,698</b>	<b>\$ -</b>	<b>\$138,211</b>
Balance January 31, 2011	11,437,911	\$23,553,245	\$1,666,199	\$(24,888,425)		\$ 34,800	\$ 365,819
Shares issued for:							
Cash	5,957,125	2,694,660				(34,800)	2,659,860
Share issue costs		(131,507)					(131,507)
Property	350,000	185,500					185,500
Stock based payments			221,454				221,454
Net loss and comprehensive loss				(902,095)			(902,095)
<b>Balances October 31, 2011</b>	<b>17,745,036</b>	<b>\$26,301,898</b>	<b>\$1,887,653</b>	<b>\$(25,794,020)</b>		<b>\$ -</b>	<b>\$ 2,399,031</b>

**CANADA RARE EARTHS INC.**  
**Notes to Condensed Interim Financial Statements**  
**(Unaudited – Expressed in Canadian Dollars)**  
**For the Nine Months Ended October 31, 2011**

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**1. NATURE OF OPERATIONS AND CONTINUANCE OF BUSINESS**

Canada Rare Earths Inc. (formerly Canada Gas Corp.) (the “Company”) was incorporated under the *Company Act* of British Columbia on February 1, 1984. During the year ended January 31, 2011, the Company changed its principal business activity from the exploration for and operation of oil and gas properties, to the exploration and development of mineral exploration assets in Canada and changed its name from Canada Gas Corp. The Company is listed on the TSX Venture Exchange in Canada, the Frankfurt Stock Exchange in Germany, and OTC Bulletin Board in the United States.

During fiscal 2011, all of the issued common shares and equity instruments of the Company were consolidated on the basis of three pre-consolidation common shares/equity instruments for one post-consolidation common share/equity instrument. As a result of the consolidation, all share and per-share information in the financial statements has been retrospectively restated to reflect the consolidation unless otherwise stated.

The interim financial statements (“financial statements”) of the Company are presented in Canadian dollars, which is the functional currency of the parent company, unless otherwise indicated.

At the date of the financial statements, the Company has not identified a known body of commercial grade mineral on any of its properties. The ability of the Company to realize the costs it has incurred to date on these properties is dependent upon the Company identifying a commercial mineral body, to finance its development costs and to resolve any environmental, regulatory or other constraints which may hinder the successful development of the property. To date, the Company has not earned any revenues and is considered to be in the exploration stage.

The financial statements have been prepared assuming the Company will continue on a going-concern basis. The Company has incurred losses since its inception and the ability of the Company to continue as a going-concern depends upon its ability to raise adequate financing and to develop profitable operations. The financial statement does not include adjustments to amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue operations.

Management is actively targeting sources of additional financing through alliances with financial, exploration and mining entities, and other business and financial transactions which would assure continuation of the Company’s operations and exploration programs. In addition, management closely monitors commodity prices of precious metals, individual equity movements, and the stock market to determine the appropriate course of action to be taken by the Company if favourable or adverse market conditions occur.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**(a) *Statement of compliance***

These interim financial statements are unaudited and have been prepared in accordance with IAS 34 ‘Interim Financial Reporting’ (“IAS 34”). The interim financial statements were authorized for issue in accordance with a resolution of the directors on December 16, 2011.

These are the Company’s third IFRS interim financial statements for part of the period covered by the Company’s first IFRS annual financial statements for the year ending January 31, 2012. Previously, the Company prepared its annual and condensed interim financial statements in accordance with Canadian Generally Accepted Accounting Principles (“Canadian GAAP”).

**CANADA RARE EARTHS INC.**  
**Notes to Condensed Interim Financial Statements**  
**(Unaudited – Expressed in Canadian Dollars)**  
**For the Nine Months Ended October 31, 2011**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**(b) Basis of presentation**

The financial statements have been prepared on the historical cost basis except for financial instruments, which are measured at fair value, as explained in the accounting policies set out in Note 2. In addition, these financial statements have been prepared using the accrual basis of accounting, except for cash flow information. The comparative figures presented in these interim financial statements are in accordance with IFRS.

The preparation of financial statements in conformity with IAS 34 requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates. These interim financial statements do not include all of the information required for full annual financial statements.

The preparation of these condensed interim financial statements resulted in changes to the accounting policies as compared with the most recent annual financial statements prepared under Canadian GAAP. The accounting policies set out below have been applied consistently to all periods presented in these financial statements. They also have been applied in preparing an opening IFRS balance sheet at February 1, 2010 for the purposes of the transition to IFRS, as required by IFRS 1, First Time Adoption of International Financial Reporting Standards (IFRS 1). The impact of the transition from Canadian GAAP to IFRS is explained in Note 3.

**(c) Functional and presentation currency**

These financial statements are presented in Canadian dollars, which is the Company's functional currency.

**(d) Property and equipment**

Property and equipment is stated at cost, less accumulated depreciation. Depreciation is primarily calculated on a straight line basis over the following terms:

Furniture and equipment	–	5 years
Leasehold improvements	–	5 years
Software license	–	2 years
Oil and gas properties	–	units of production

Additions during the year, except for oil and gas properties, are amortized at one-half the annual rates.

The net carrying value of oil and gas properties is depreciated using the unit of production method by reference to the ratio of production in the period to the related proved and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

**CANADA RARE EARTHS INC.**  
**Notes to Condensed Interim Financial Statements**  
**(Unaudited – Expressed in Canadian Dollars)**  
**For the Nine Months Ended October 31, 2011**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Proved and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. Proved reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated proved reserves. Probable reserves are those additional reserves that are less certain to be recovered than proved reserves. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves.

Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and
- evidence that the necessary production, transmission and transportation facilities are available or can be made available.

Reserves may only be considered proved and probable if producibility is supported by either actual production or conclusive formation test. The area of reservoir considered proved and probable includes (a) that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any, or both, and (b) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geophysical, geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of oil and natural gas controls the lower proved limit of the reservoir.

Reserves which can be produced economically through application of improved recovery techniques (such as fluid injection) are only included in the proved and probable classification when successful testing by a pilot project, the operation of an installed program in the reservoir, or other reasonable evidence (such as, experience of the same techniques on similar reservoirs or reservoir simulation studies) provides support for the engineering analysis on which the project or program was based.

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on disposal of the asset, determined as the difference between the net disposal proceeds and the carrying amount of the asset, is recognized in profit or loss.

Where an item of property and equipment comprises major components with different useful lives, the components are accounted for as separate items of property and equipment. Expenditures incurred to replace a component of an item of property and equipment that is accounted for separately, including major inspection and overhaul expenditures are capitalized.

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

**CANADA RARE EARTHS INC.**  
**Notes to Condensed Interim Financial Statements**  
**(Unaudited – Expressed in Canadian Dollars)**  
**For the Nine Months Ended October 31, 2011**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**(e) Impairment of assets**

At the end of each reporting period, the Company assesses each cash generating unit to determine whether there is any indication that those assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment, if any. The recoverable amount is the higher of fair value less costs to sell and value in use. Fair value is determined as the amount that would be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss is recognized in profit or loss for the period. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which the asset belongs.

Where an impairment subsequently reverses, the carrying amount of the asset (or cash generating unit) is increased to the revised estimate and its recoverable amount, but to an amount that does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss.

**(f) Exploration and evaluation assets**

Exploration and evaluation assets include the costs of acquiring licenses, costs associated with exploration and evaluation activity, and the fair value (at acquisition date) of exploration and evaluation assets acquired in a business combination. All costs related to the acquisition, exploration and development of exploration and evaluation assets are capitalized by property as an intangible asset. Costs incurred before the Company has obtained the legal rights to explore an area are recognized in profit or loss.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

Once the technical feasibility and commercial viability of the extraction of mineral resources in an area of interest are demonstrable, exploration and evaluation assets attributable to that area of interest are first tested for impairment and then reclassified to mining property and development assets within equipment.

Recoverability of the carrying amount of the exploration and evaluation assets is dependent on successful development and commercial exploitation, or alternatively, sale of the respective areas of interest.

**(g) Determination of cash generating units**

Oil and gas properties are grouped into cash generating units for purposes of impairment testing. Management has evaluated the oil and gas properties of the Company, and grouped the properties into cash generating units on the basis of their ability to generate independent cash flows, similar reserve characteristics, geographical location, and shared infrastructure.

**CANADA RARE EARTHS INC.**  
**Notes to Condensed Interim Financial Statements**  
**(Unaudited – Expressed in Canadian Dollars)**  
**For the Nine Months Ended October 31, 2011**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**(h) Decommissioning, restoration and similar liabilities (“Asset retirement obligation” or “ARO”)**

The Company records the present value of estimated costs of legal and constructive obligations required to restore the site in the period in which the obligation is incurred. The nature of these restoration activities include dismantling and removing structures, rehabilitating mines and tailings dam, dismantling facilities, closure of plant and waste sites and restoration, reclamation and re-vegetation of affected areas.

The future obligations for mine closure activities are estimated by the Company using mine closure plans or other similar studies which outline the requirements that will be carried out to meet the obligations. Since the obligations are dependent on the laws and regulations of the countries in which the mines operate, the requirements could change as a result of amendments in the laws and regulations relating to environmental protection and other legislation affecting resource companies.

As the estimate of the obligations is based on future expectations, a number of assumptions and judgments are made by management in the determination of closure provisions. The closure provisions are more uncertain the further into the future the mine closure activities are to be carried out.

The present value of decommissioning and site restoration provision as a long-term liability as incurred and records an increase in the carrying value of the related asset by a corresponding amount. The provision is discounted using a nominal, risk free pre-tax discount rate. Charges for accretion and restoration expenditures are recorded as operating activities. The related decommissioning provision is recorded as part of the mineral property and depreciated accordingly. In subsequent periods, the carrying amount of the liability is accreted by a charge to the statement of operations to reflect the passage of time and the liability is adjusted to reflect any changes in the timing of the underlying future cash flows.

Changes to the obligation resulting from any revisions to the timing or amount of the original estimate of undiscounted cash flows are recognized as an increase or decrease in the decommissioning provision, and a corresponding change in the carrying amount of the related long-lived asset. Where rehabilitation is conducted systematically over the life of the operation, rather than at the time of closure, or provision is made for the estimated outstanding continuous rehabilitation work at each balance sheet date and the cost is charged to the statement of operations.

The Company had no asset retirement obligations as of October 31, 2011, January 31, 2011, and February 1, 2010.

**(i) Related party transactions**

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties.

**CANADA RARE EARTHS INC.**  
**Notes to Condensed Interim Financial Statements**  
**(Unaudited – Expressed in Canadian Dollars)**  
**For the Nine Months Ended October 31, 2011**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**(j) Earnings (loss) per share**

The Company presents basic and diluted loss per share data for its common shares, calculated by dividing the earnings (loss) attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted loss per share does not adjust the gain or loss attributable to common shareholders or the weighted average number of common shares outstanding when the effect is anti-dilutive.

**(k) Stock-based payments**

The fair value method of accounting is used for stock-based awards issued to employees and non-employees. Under this method, stock options, restricted shares and restricted share units issued to employees are recorded at their estimated fair value on the grant date and are charged either to the statement of comprehensive profit or loss or capitalized to development costs over the vesting period with a corresponding credit to reserves. For stock-based awards issued to non-employees, the awards are fair valued at each balance sheet date with any changes in the fair value charged to the statement of comprehensive profit or loss or capitalized to development costs. If the stock options are exercised, the proceeds are credited to share capital and the fair value of the options exercised is reclassified from reserves to share capital. Restricted shares are issued from treasury at date on the grant and are fair valued at the date of grant. The fair value is either charged to the statement of comprehensive profit or loss or capitalized to development costs over the vesting period. On the vesting date, the fair value is transferred from reserves to share capital. For options subject to vesting, the Company calculates the fair value of each vesting period as separate awards with individual expected lives and amortizes the calculated expense for the award on a straight-line basis over the vesting period of the award. The forfeiture rate is reviewed on quarterly basis to determine the appropriate forfeiture rate based on past, present and expected forfeitures. The fair value of stock-based awards is trued up on vesting.

**(l) Income taxes**

Current tax is the expected tax payable or receivable on the local taxable income or loss for the year, using local tax rates enacted or substantively enacted at the balance sheet date, and includes any adjustments to tax payable or receivable in respect of previous years.

Deferred income taxes are recorded using the balance sheet method whereby deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they are realized or settled, based on the laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is not recognized for temporary differences which arise on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting, nor taxable profit or loss.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

**CANADA RARE EARTHS INC.**  
**Notes to Condensed Interim Financial Statements**  
**(Unaudited – Expressed in Canadian Dollars)**  
**For the Nine Months Ended October 31, 2011**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**(m) Financial assets**

All financial assets are initially recorded at fair value and designated upon inception into one of the following four categories: held to maturity, available-for-sale, loans and receivables or at fair value through profit or loss (“FVTPL”).

Financial assets such as marketable securities and assets held for sale are classified as FVTPL are measured at fair value with unrealized gains and losses recognized through earnings.

Financial assets classified as loans and receivables and held to maturity assets are measured at amortized cost. The Company’s accounts receivable are classified as loans and receivables. Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income and loss except for losses in value that are considered other than temporary which are recognized in earnings. At October 31, 2011, January 31, 2011 and February 1, 2010, the Company has not classified any financial assets as available-for-sale.

Transactions costs associated with FVTPL financial assets are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset.

**(n) Financial liabilities**

All financial liabilities are initially recorded at fair value and designated upon inception as FVTPL or other financial liabilities.

Financial liabilities classified as other financial liabilities are initially recognized at fair value less directly attributable transaction costs. After initial recognition, other financial liabilities are subsequently measured at amortized cost using the effective interest rate method. The effective interest rate method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period. The Company’s accounts payable and accrued liabilities and related party payable are classified as other financial liabilities.

Financial liabilities held for trading and financial liabilities designated upon initial recognition as FVTPL. Derivatives, including separated embedded derivatives are also classified as held for trading and recognized at fair value with changes in fair value recognized in earnings unless they are designated as effective hedging instruments. Fair value changes on financial liabilities classified as FVTPL are recognized in statement of comprehensive profit or loss.

**(o) Interest in Joint Venture**

The Company’s oil and natural gas exploration and production activities are conducted through a joint venture which the joint venture participants are bound by a contractual agreement establishing joint control over the assets of the joint venture. The Company records its proportionate share of the jointly controlled assets, liabilities, revenue and operating expenses of the joint venture.

**CANADA RARE EARTHS INC.**  
**Notes to Condensed Interim Financial Statements**  
**(Unaudited – Expressed in Canadian Dollars)**  
**For the Nine Months Ended October 31, 2011**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**(p) Revenue recognition**

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer which is usually when legal title passes to the external party. For natural gas, this is generally at the time product enters the pipeline. For crude oil, this is generally at the time the product reaches a trucking terminal. For natural gas liquids, this is generally at the time the product reaches a gas plant. Revenue is measured net of discounts, customs duties and royalties. With respect to the latter, the entity is acting as a collection agent on behalf of others.

**(q) New standards, amendments and interpretations not yet effective**

Certain new standards, interpretations and amendments to existing standards have been issued by the International Accounting Standards Board (IASB) or International Financial Reporting Interpretations Committee (IFRIC) that are mandatory for accounting periods beginning after February 1, 2010, or later periods. Some updates that are not applicable or are not consequential to the Company may have been excluded from the list below.

**Accounting standards effective February 1, 2012**

*Financial instruments disclosure*

In October 2010, the IASB issued amendments to IFRS 7 – *Financial Instruments: Disclosures* that improve the disclosure requirements in relation to transferred financial assets. The amendments are effective for annual periods beginning on or after July 1, 2011, with earlier adoption permitted. The Company does not anticipate this amendment to have a significant impact on its financial statements.

*Income taxes*

In December 2010, the IASB issued an amendment to IAS 12 – *Income taxes* that provide a practical solution to determining the recovery of investment properties as it relates to the accounting for deferred income taxes. This amendment is effective for annual periods beginning on or after July 1, 2011, with earlier adoption permitted. The Company does not anticipate this amendment to have a significant impact on its condensed consolidated financial statements.

**Accounting standards anticipated to be effective February 1, 2013**

*Joint ventures*

The IASB issued IFRS 11 – *Joint Arrangements* on May 12, 2011. IFRS 11 eliminates the Company's choice to proportionately consolidate jointly controlled entities and required such entities to be accounted for using the equity method and proposes to establish a principles-based approach to the accounting for joint arrangements which focuses on the nature, extent and financial effects of the activities that an entity carries out through joint arrangements and its contractual rights and obligations to assets and liabilities, respectively, of the joint arrangements. The Company is currently evaluating the impact IFRS 11 is expected to have on its financial statements.

*Financial instruments*

IFRS 9, *Financial Instruments: Classification and Measurement*, effective for annual periods beginning on or after February 1, 2013, with early adoption permitted, introduces new requirements for the classification and measurement of financial instruments. Management anticipates that this standard will be adopted in the Company's financial statements for the period beginning February 1, 2013, and has not yet considered the potential impact of the adoption of IFRS 9.

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*Fair-value measurement*

IFRS 13, Fair Value Measurement: effective for annual periods beginning on or after February 1, 2013, with early adoption permitted, sets out in a single IFRS a framework for measuring fair value and new required disclosures about fair value measurements. Management anticipates that this standard will be adopted in the Company's financial statements for the period beginning February 1, 2013, and has not yet considered the potential impact of the adoption of IFRS 13.

**3. FIRST TIME ADOPTION OF IFRS**

The Company has adopted IFRS with a transition date of February 1, 2010. Under IFRS 1 'First-time Adoption of International Financial Reporting Standards', the IFRS are applied retrospectively at the transition date with all adjustments to assets and liabilities as stated under Canadian GAAP taken to retained earnings unless certain exemptions are applied.

The guidance for first time adoption of IFRS is set out in IFRS 1. IFRS 1 provides for certain mandatory exceptions and optional exemptions for first time adopters of IFRS. The Company has applied the following exemptions on first-time adoption of IFRS:

- to measure their oil and gas assets at the amount determined under the Canadian GAAP at the date of transition. This amount is pro-rated to the underlying assets based upon the value of proved and probable reserves at transition date, discounted at 10%;
- to measure restoration and similar liabilities at the date of transition and recognize directly in retained earnings any difference between that amount and the carrying amount determined under Canadian GAAP.
- to apply IAS 17, *Leases*, as of the date of adoption rather than the lease inception date;
- to apply the requirements of IFRS 2, *Share-based payments*, only to equity instruments granted after November 7, 2002 which had not vested as of the Transition Date;
- to not account for business combinations that occurred prior to the date of transition using the principles of IFRS 3 – Business Combinations and instead retain the accounting treatment applied under Canadian GAAP; and
- to apply the requirements of IAS 23, *Borrowing Costs*, prospectively from the date of transition.

The IFRS 1 elections, identified above, and the significant accounting policies, set out in note 2, have been applied in preparing the financial statements and the selected unaudited comparative information. The reconciliation for the first quarter transition period of the Company's unaudited condensed statements of financial position and statements of loss and comprehensive loss with those prepared in accordance with Canadian GAAP and as previously reported to those prepared and reported in the unaudited condensed interim financial statements in accordance with IFRS are shown in note 3 to the financial statements for the first quarter ended April 30, 2011.

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**4. MARKETABLE SECURITIES AND WARRANTS**

	2011	2010
Hemisphere Energy Corp. – 178,725 shares, cost	\$ 41,714	\$ -
Change in fair value	13,690	-
<b>Balance, January 31, 2011</b>	<b>55,404</b>	
Disposition of securities	(43,004)	
Change in fair value	14,400	
<b>Balance, October 31, 2011</b>	<b>\$ 26,800</b>	<b>\$ -</b>

On April 27, 2010, the Company acquired 214,225 shares of Hemisphere as partial consideration of the disposal of producing Canadian oil and gas interests. During the nine month period ended October 31, 2011, the Company sold 138,725 Hemisphere shares for total proceeds of \$55,834.

**5. PROPERTY AND EQUIPMENT**

<b>Cost</b>	Oil and gas interest, and well equipment	Furniture and equipment	Leasehold improvements	Software license	Total
As at February 1, 2010	\$ 66,327	\$ 3,200	\$ 14,967	\$ 10,930	\$ 95,424
Additions	6,149	-	-	-	6,149
As at January 31, 2011	\$ 72,476	\$ 3,200	\$ 14,967	\$ 10,930	\$ 101,573
As at January 31, 2011	\$ 72,476	\$ 3,200	\$ 14,967	\$ 10,930	\$ 101,573
Additions	0	26,668	0	0	26,668
As at October 31, 2011	\$ 72,476	\$ 29,868	\$ 14,967	\$ 10,930	\$ 128,241
<b>Accumulated Depreciation</b>	Oil and gas interest, and well equipment	Furniture and equipment	Leasehold improvements	Software license	Total
As at February 1, 2010	\$ -	\$ 1,997	\$ 9,339	\$ 8,471	\$ 19,807
Depreciation	-	640	2,994	2,459	6,093
As at January 31, 2011	\$ -	\$ 2,637	\$ 12,333	\$ 10,930	\$ 25,900
As at January 31, 2011	\$ -	\$ 2,637	\$ 12,333	\$ 10,930	\$ 25,900
As at October 31, 2011	\$ -	\$ 2,637	\$ 12,333	\$ 10,930	\$ 25,900
Net book value:					
As at February 1, 2010	\$ 66,327	\$ 1,203	\$ 5,628	\$ 2,459	\$ 75,617
As at January 31, 2011	\$ 72,476	\$ 563	\$ 2,634	\$ -	\$ 75,673
As at October 31, 2011	\$ 72,476	\$ 27,231	\$ 2,634	\$ -	\$ 102,341

No overhead charges have been capitalized to oil and gas properties for the years ended January 31, 2011 and 2010.

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**6. EXPLORATION AND EVALUATION ASSETS**

Expenditures incurred on the Company's exploration and evaluation assets are as follows:

	<b>Goeland Property</b>	<b>Manouane Property</b>
<b>Balance, January 31, 2009 and 2010</b>	<b>\$ -</b>	<b>\$ -</b>
Acquisition cost	190,000	-
<b>Balance, January 31, 2011</b>	<b>\$ 190,000</b>	<b>\$ -</b>
Acquisition cost	-	196,427
Deferred exploration costs	675,502	74,942
<b>Balance, October 31, 2011</b>	<b>\$ 865,502</b>	<b>\$ 271,369</b>

**Goeland Rare Earth Project**

The Company entered into an option agreement to acquire a 100% interest in the Goeland property located north of Val d'Or in the Abitibi region of Quebec. To exercise its option, the Company must complete the following.

A cash payment of \$25,000 on signing (paid); and issuance of 2,500,000 common shares of the Company to optionors as follows:

- (i) 1,000,000 common shares upon TSX-V approval (January 21, 2011, issued and valued at \$150,000);
- (ii) 500,000 common shares 12 months after TSX-V approval;
- (iii) 500,000 common shares 24 months after TSX-V approval; and
- (iv) 500,000 common shares 36 months after TSX-V approval.

In conjunction with the completion of the transaction, a finder's fee of 100,000 shares (valued at \$15,000) was issued upon TSX-V approval. The optionor has retained a 2% net smelter return royalty on the value of minerals produced and delivered from the property.

**Manouane Rare Earth Project**

On August 4, 2011, the Company entered into an option agreement with Benoit Moreau, VP Exploration of the Company, to acquire a 100% interest in the 6,955 hectare Manouane rare earth property, located west of the town La Tuque, Quebec, roughly 250 km southeast of Val d'Or, or 350 km south of Montviel. To complete the non-arms length transaction, the Company has paid the vendor \$7,500 upon signing of the letter of intent, and has issued 350,000 common shares of the Company with a deemed value of \$0.53 per share upon TSX-V final approval (September 15, 2011). The vendor retains no royalty and there are no other royalties payable on the property.

**Title to exploration and evaluation assets**

Title to exploration and evaluation assets involves certain inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently ambiguous conveyance history characteristic of many exploration and evaluation assets. The Company has investigated title to all of its exploration and evaluation assets and, to the best of its knowledge, title to all of its properties for which titles have been issued are in good standing. Although the Company has taken steps to verify the title to exploration and evaluation assets in which it has or has a right to acquire an interest in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee title (whether of the Company or of any underlying vendor(s) from whom the Company may be acquiring its interest). Title to exploration and evaluation assets may be subject to unregistered prior agreements or transfers, and may also be affected by undetected defects or the rights of indigenous peoples.

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**6. EXPLORATION AND EVALUATION ASSETS (continued)**

**Environmental protection and reclamation costs**

The operations of the Company have been, and may in the future be, affected from time to time in varying degrees by changes in environmental regulations, including those for future removal and site restoration costs. Both the likelihood of new regulations and their overall effect upon the Company may vary from region to region and are not predictable.

The Company's policy is to meet or, if possible, surpass standards set by relevant legislation, by application of technically proven and economically feasible measures. Environmental expenditures that relate to ongoing environmental and reclamation programs will be recognized as a charge in the statements of operations as incurred or capitalized and amortized depending upon their future economic benefits. The Company does not currently anticipate any material capital expenditures for environmental control facilities because all property holdings are at early stages of exploration. Therefore, estimated future removal and site restoration costs are presently considered minimal.

All phases of the Company's operations are subject to environmental regulations. Environmental legislation in the countries in which the Company is currently performing exploration work is evolving in a manner that will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibilities for companies and their officers, directors and employees. Although, presently, compliance with such laws is not a significant factor in the Company's operations, there is no assurance that future changes in environmental regulations, if any, will not adversely affect the Company's operations.

**Realization**

The recorded cost of exploration and evaluation asset interests is based on cash paid, and the value of share considerations to date. The recorded amount does not reflect present or future values as this will be dependent on any production decision and associated development program, the nature of the deposit, commodity prices, adequate funding and the ability of the Company to bring its projects into production, or realize proceeds from disposition.

**7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

	October 31, 2011	January 31, 2011	February 1, 2010
Due within the year			
Trade payables	\$ 14,249	\$ 26,410	\$ 61,552
Accruals	-	30,000	30,000
Payroll and other payables	-	-	41,030
	\$ 14,249	\$ 56,410	\$ 132,582

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**8. RECOVERY OF EXPENSES**

On November 23, 2009, the Company entered into a Debt Assignment Agreement with Award Ventures Ltd. (“AVL”) (formerly Wyn Metals Inc.), a director of the Company, and an arm’s-length third party Lender. In accordance with the terms of the Debt Assignment Agreement, the Company assigned \$21,065 due to a director of the Company to AVL. The Company also assigned to AVL \$85,000 in outstanding short-term loan payable to an arm’s-length third party for the outstanding principal of a March 9, 2007 short-term loan. As a result of this Debt Assignment Agreement, the Company reduced its amount due to a related party and short-term loan by \$106,065 and recorded a recovery of expenses during the year ended January 31, 2010.

**9. RELATED PARTY TRANSACTIONS**

The following amounts were incurred by the Company during the nine month period ended October 31, 2011:

- (a) \$29,750 (2010 - \$21,079) for accounting fees payable to a company controlled by an officer of the Company; and
- (b) \$93,000 (2010 – recovered \$23,692) for management fees payable to companies controlled by directors and/or officers of the Company for management services.

All of the above transactions and balances are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

- (c) During the year ended January 31, 2011, the Company entered into shares for debt agreements to settle \$164,115 of amounts due to related parties by issuing 1,094,101 common shares at a deemed value of \$0.15 per share. The transaction received regulatory approval on July 21, 2010.
- (d) During the year ended January 31, 2011, the Company entered into shares for debt agreements to settle \$164,115 of amounts due to related parties by issuing 1,094,101 common shares at a deemed value of \$0.15 per share. The transaction received regulatory approval on July 21, 2010.
- (e) During the year ended January 31, 2011, the Company recovered a net balance of \$16,192 in management fees, comprised of directors and officers having forgiven \$60,192 of amounts due to related parties owed by the Company for past management fees, and \$44,000 in management fees charged.
- (f) On June 7, 2010, the Company received regulatory approval and entered into a convertible loan agreement with a related party, pursuant to which the Company borrowed \$100,000 from the related party. The principal was repayable six months from regulatory approval and the related party had the right to convert any outstanding portion of the principal into units at \$0.15 per unit. Each unit would consist of one common share and one share purchase warrant exercisable into an additional common share at a price of \$0.30 per warrant for a period of three years from the date of issuance of the warrant.

As consideration for the convertible loan, the Company paid the related party a fee equal to 133,333 shares at a deemed price of \$0.15 per share. The short term convertible loan bears zero interest unless the loan remains outstanding after the Maturity Date. If the principal balance is not paid in full by Maturity Date, the Company was obligated to pay interest of 5.0% pa to the Lender calculated from Maturity Date. As consideration for the convertible loan, the Company paid the related party a bonus equal to 133,333 shares at

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a deemed price of \$0.15 per share upon regulatory approval. The related party forgave all interest payable by the Company and on January 12, 2011, the related party exercised its option to convert the outstanding loan into units. As a result, the convertible loan of \$100,000 was extinguished in exchange for 666,667 shares at a deemed price of \$0.15 per share and 666,667 share purchase warrants exercisable for three years at a price of \$0.30 per warrant.

- (g) During the year ended January 31, 2010, the Company entered into shares for debt agreements to settle \$140,500 of accounts payable due to related parties by issuing 936,667 common shares at a deemed value of \$0.15 per share. The transaction received regulatory approval on October 7, 2009.

The Company has identified its directors and certain senior officers as its key management personnel. The compensation costs for key management personnel for the nine months ended October 31, 2011 and 2010 are as follows:

	2011	2010
Salaries and benefits (note 9a and b)	\$ 122,750	\$ (23,692)
Stock-based payments	50,522	\$ -
	\$ 173,272	\$ (23,692)

**10. SHARE CAPITAL**

- (a) Authorized: Unlimited common shares without par value
- (b) Issued and outstanding:
- (i) On October 7, 2009, the Company received regulatory approval and closed shares for debt agreements by issuing 1,700,000 common shares at a fair value of \$0.15 per share. The Company settled \$255,000 in short-term loans comprised of \$140,500 owed to related parties, and \$114,500 owed to lenders on short-term loans.
- (ii) On June 7, 2010 the Company paid a bonus to a related party equal to 133,333 shares at a fair value of \$0.15 per share pursuant to a convertible loan agreement (note 9(f)).
- (iii) On July 12, 2010, the Company received regulatory approval and closed shares for debt agreements by issuing 1,094,101 common shares at a fair value of \$0.15 per share. The Company settled \$164,115 in short-term loans owed to related parties.
- (iv) On January 12, 2011, the related party exercised its option to convert an outstanding loan into units, which has resulted in 666,667 shares and 666,667 warrants being granted to the related party.
- (v) On January 21, 2011 the Company issued 1,100,000 shares pursuant to the acquisition of exploration and evaluation assets.
- (vi) On February 2, 2011, the Company closed a private placement by issuing 1,833,330 non-flow through units at \$0.15 per unit for gross proceeds of \$275,000. Each unit is comprised of one common share and one share purchase warrant exercisable at \$0.25 for a period of 24 months from the closing date. Proceeds of \$34,800 for this private placement were received prior to yearend.

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**10. SHARE CAPITAL** (continued)

- (vii) On March 28, 2011, the Company closed a private placement by issuing 3,481,130 non-flow through units at \$0.65 per unit for gross proceeds of \$2,262,735 with finder's fees paid of \$131,507. Each unit is comprised of one common share and one half of one share purchase warrant exercisable at \$0.90 per share for a period of 24 months from the closing date.
  - (viii) During the three months ended July 31, 2011, a total of 445,666 warrants were exercised at a price of \$0.25 per share, generating aggregate proceeds of \$111,417.
  - (ix) On September 15, 2011, 350,000 common shares were issued pursuant to the acquisition of the Manouane rare earth property, which received TSX-V final approval on September 15, 2011 (see note 6 to the financial statements).
  - (x) During the three months ended October 31, 2011, a total of 121,999 warrants were exercised at a price of \$0.25 per share, generating aggregate proceeds of \$30,500.
  - (xi) During the three months ended October 31, 2011, a total of 75,000 incentive stock options were exercised at a price of \$0.22 per share, generating aggregate proceeds of \$16,500.
- (c) Stock options

The Company has established a stock option plan whereby the Board of Directors may, from time to time, grant options to directors, officers, employees or consultants. Options granted must be exercised no later than five years from the date of grant or such lesser period as determined by the Company's Board of Directors. The exercise price of an option is not less than the closing price of the stock on the last trading day preceding the grant date. At the Company's August 5, 2011 AGM, the shareholders of the Company approved the Company's 2011 fixed 20% stock option plan, allowing for an aggregate of 3,427,874 option shares to be reserved for issuance under the option plan on the approval date. As at October 31, 2011 there are 2,975,000 stock options outstanding as follows:

	2011		2010	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Balance, January 31	950,000	\$ 0.25	666,667	\$ 0.78
Forfeited	(112,500)	\$ 0.46	(666,667)	\$ 0.78
Expired	(112,500)	-	-	-
Exercised	(75,000)	\$ 0.47	-	-
Granted	2,325,000	\$ 0.50	-	-
Balance, October 31	2,975,000	\$ 0.50	-	\$ 0.78

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**10. SHARE CAPITAL** (continued)

Expiry Date	Exercise Price	Number of Shares
January 10, 2016	\$ 0.22	575,000
January 25, 2016	\$ 0.30	300,000
February 25, 2016	\$ 0.72	200,000
April 19, 2016	\$ 0.66	225,000
May 31, 2012	\$ 0.45	175,000
August 15, 2016	\$ 0.50	1,500,000
		2,975,000

There were 1,675,000 options vested and exercisable at October 31, 2011 with a weighted average exercise price of \$0.50.

(d) Share purchase warrants

	2011		2010	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Balance outstanding and exercisable, January 31	666,667	\$ 0.30	1,489,167	\$ 0.78
Issued	3,573,894	\$ 0.52	-	-
Exercised	(567,665)	\$ 0.57	-	-
Expired	-	-	(1,489,167)	\$ 0.78
Balance outstanding and exercisable, October 31	3,672,896	\$ 0.57	-	\$ 0.78

As at October 31, 2011, the following share purchase warrants were outstanding and exercisable:

Expiry Date	Exercise Price	Number of Warrants	
		2011	2010
January 10, 2014	\$ 0.30	666,667	-
February 2, 2013	\$ 0.25	1,265,665	-
March 21, 2013	\$ 0.90	1,740,564	-
		3,672,896	-

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**10. SHARE CAPITAL** (continued)

(e) Stock-based payments

Stock-based payments in the amount of \$221,454 (2010 - \$nil) has been recorded as an expense in the period ended October 31, 2011. The stock-based payments would be allocated as follows:

	2011	2010
Consultants	\$ 120,411	\$ -
Officers	57,739	-
Directors	43,304	-
	\$ 221,454	\$ -

The fair value of stock options used to calculate compensation expense is estimated using the Black-Scholes option pricing model with the following weighted average assumptions and resulting fair value:

	2011	2010
Expected life (years)	5.00	N/A
Interest rate	2.61%	N/A
Volatility	117.77%	N/A
Dividend yield	-	N/A
Grant date fair value	\$0.567	N/A

(f) Share compensation reserve

	2011	2010
Balance, beginning of period	\$ 1,666,199	\$ 1,544,809
Stock-based payments for period	221,454	-
Balance, end of period	\$ 1,887,653	\$ 1,544,809

**11. CAPITAL MANAGEMENT**

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

The Company currently has limited revenues and is dependent upon equity financings or loan advances to fund activities. In order to carry future projects and pay for administrative costs, the Company will spend its existing working capital and raise additional funds as needed. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. There were no changes in the Company's approach to capital management during the period ended October 31, 2011. The Company is not subject to externally imposed capital requirements.

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**12. RISK MANAGEMENT AND FINANCIAL INSTRUMENTS**

(a) Fair value

The carrying values of cash, accounts receivable, and accounts payable and accrued liabilities approximate their fair values due to the short term to maturity of these financial instruments; therefore, disclosure is not made of their level in the fair value hierarchy.

The fair values of due to related parties have not been disclosed as their fair values cannot be reliably measured since the parties are not at arm's length and there is no active, liquid market for similar instruments. The Company's financial instruments measured at fair value by level within the fair value hierarchy as at October 31, 2011 are as follows:

	Level 1	Level 2	Level 3	Total
<b>Financial Assets</b>				
FVTPL				
Marketable securities	\$ 26,800	\$ -	\$ -	\$ 26,800

(b) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company is exposed to credit risk with respect to its cash; however, the risk is minimized as cash is held at a major financial institution.

(c) Market risk

Market risk is the risk that changes in market prices, such as interest rates or other prices, will affect the Company's income or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return. The Company is exposed to market risk as follows:

(i) Interest rate risk

The Company is not exposed to significant interest rate price risk due to the short term to maturity of its monetary assets and liabilities.

(ii) Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices, other than those arising from interest rate risk or currency risk.

The Company is exposed to other price risk with respect to its marketable securities. The sensitivity analysis of the Company's exposure to other price risk at the reporting date has been determined based upon hypothetical changes taking place at October 31, 2011, which includes a hypothetical change in the share price of Hemisphere Energy Corp. ("Hemisphere"), which would result in a change in net income of \$14,400.

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**12. RISK MANAGEMENT AND FINANCIAL INSTRUMENTS (Continued)**

(iii) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in satisfying its financial obligations as they fall due. The Company manages its liquidity risk by forecasting cash flows from operations and anticipated investing and financing activities. At October 31, 2011, the Company had a cash balance of \$1,020,529 and accounts payable and accrued liabilities of \$14,249. The accounts payable and accrued liabilities are due within 30 days. Liquidity risk is mitigated by the Company having sufficient cash to meet its obligations for 2012.

**13. DISCONTINUED OPERATIONS**

On July 15, 2010, the Company disposed of certain producing Canadian oil and gas interests for total proceeds comprising \$300,000 in cash and 214,225 shares of Hemisphere valued at \$50,000, resulting in a gain of \$135,095 during the second quarter ended July 31, 2010. During the comparative quarter ended July 31, 2010, the gain was eliminated and the property was written up during the quarter ended April 30, 2010 (as shown in the financial statements for the first quarter ended April 30, 2011), resulting in a reversal of impairment based on the date the letter of intent was signed, being April 27, 2010. During the quarter ended October 31, 2011, the Company recovered an additional \$1,246 in operating costs from Hemisphere as shown below.

The decision to discontinue this operation was made due to the fact that it was producing a negative cash flow, and the Company was in need of working capital in order to pay critical outstanding accounts payable.

Subsequent to the disposal of the oil and gas interests, the operations and cash flows of the component have been eliminated from the ongoing operations of the Company.

Summarized selected quarterly financial information for the discontinued operations is as follows:

	<b>October 31, 2011</b>	<b>October 31, 2010</b>
Revenues	\$ -	\$ 29,358
Expenses		
Operating	(1,246)	26,939
Income (loss) from discontinued operations, net of tax	1,246	2,419
Reversal of Impairment of property and equipment	-	-
Income from discontinued operations, net of tax	\$ 1,246	\$ 2,419

**14. SUBSEQUENT EVENTS**

Subsequent to October 31, 2011, the following transactions and events occurred:

- (a) A total of 99,832 share purchase warrants were exercised at \$0.25, resulting in aggregate proceeds of \$24,958;

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**14. SUBSEQUENT EVENTS** (Continued)

- (b) On December 9, 2011, the Company announced that it signed a Pre-Development Agreement (“PDA”) with the Grand Council of the Crees (Eeyou Istchee)/The Cree Regional Authority and the Cree First Nation of Waswanipi, (collectively referred to as the “Parties”) regarding the Company’s exploration activities on its Goeland rare earth project, Quebec. The PDA has been designed to acknowledge mutual respect and ensure the responsible and cooperative exploration and development of the Goeland rare earth project in the best interests of all parties. Under the terms of the PDA, the Parties will work together to the best of their ability to ensure the continuation of a successful mining venture at Goeland. The PDA provides for business, employment and advancement opportunities for the Cree people and the hiring of the tallyman of the W11B Territory as the Environmental Monitor for the Goeland project. The PDA also provides for the completion of a comprehensive Business and Employment Study to assess the full potential for Cree business and employment opportunities, the creation of a joint communication strategy and the establishment of a PDA committee comprised of two members appointed by the Company and one member appointed by each of Waswanipi and the Grand Council of the Crees (EI)/Cree Regional Authority.

In exchange, the Cree parties have agreed to support the Company’s exploration and development activities, including by assisting the Company in the preparation of required environmental and social assessment studies. This framework highlights several key conditions of a mutually beneficial partnership between the Parties during the exploration phase of the project and contemplates terms for a Social and Economic Participation Agreement to be negotiated by the Parties if a successful pre-feasibility study is filed for the project. In consideration for Waswanipi entering into the PDA and the performance of its obligations, the Company will pay to Waswanipi an annual amount of \$25,000 for the term of the PDA, and issue to the Waswanipi Development Corporation the number of common shares of the Company that is equal to \$250,000 divided by the greater of \$0.40 and a ten day average closing price, subject to TSX-V approval and the completion of certain legal matters. The shares will be subject to a four month securities law hold period and a contractual undertaking not to sell 50% of the shares before the first anniversary date of the PDA.