



TALON METALS CORP.

Condensed Consolidated Interim Financial Statements

September 30, 2012 and 2011

(Unaudited)

(Expressed in Canadian Dollars)

These unaudited condensed consolidated interim financial statements of Talon Metals Corp. (the "Company") have not been reviewed by the auditors of the Company. This notice is being provided in accordance with Section 4.3(3) (a) of National Instrument 51-102 Continuous Disclosure Obligations.

Talon Metals Corp.
Condensed Consolidated Interim Statements of Financial Position

(Expressed in Canadian Dollars)

(Unaudited)

	<i>Notes</i>	September 30, 2012	December 31, 2011
Assets			
Current assets			
Cash and cash equivalents		\$ 17,046,187	\$ 21,570,417
Investments	5	1,939,274	1,898,300
Prepayments		144,624	94,426
Accounts and other receivables		78,711	229,894
		<u>19,208,796</u>	<u>23,793,037</u>
Non-current assets			
Equipment		128,151	151,936
Resource properties and deferred expenditures	6	18,003,290	15,567,320
Investment in Plou Energy	5	18,593,029	19,615,514
Assets held for sale	7	262,400	1,715,378
		<u>19,886,870</u>	<u>27,094,138</u>
Total assets		<u>\$ 56,195,667</u>	<u>\$ 60,843,185</u>
Liabilities and Equity			
Current liabilities			
Accounts payable and accrued liabilities		<u>\$ 954,422</u>	<u>\$ 1,100,003</u>
Equity			
Share capital	8	68,560,242	68,501,013
Common share purchase warrants	8	5,546,292	5,546,292
Contributed surplus		14,164,090	13,577,709
Accumulated other comprehensive loss		(814,430)	(723,363)
Deficit		<u>(32,214,950)</u>	<u>(27,158,469)</u>
		<u>55,241,244</u>	<u>59,743,182</u>
Total liabilities and equity		<u>\$ 56,195,667</u>	<u>\$ 60,843,185</u>

See accompanying notes to the condensed consolidated interim financial statements.

Approved by the Audit Committee on November 13, 2012

Signed:

"Gregory S. Kinross"

"Jonathan M. Schneider"

Talon Metals Corp.
Condensed Consolidated Interim Statements of Loss and Comprehensive Loss

(Expressed in Canadian Dollars)

(Unaudited)

	Notes	Three months ended September 30,		Nine months ended September 30,	
		2012	2011	2012	2011
Revenue					
Interest income		\$ 56,654	\$ 3,615	\$ 418,568	\$ 110,219
Expenses					
Office and general		337,508	438,114	592,528	723,223
Professional fees		83,367	194,674	282,595	654,660
Share-based payments		216,803	574,980	615,631	5,493,537
Salaries, benefits, consulting and management fees		280,800	434,208	1,701,018	1,132,502
Distribution of Rio Verde shares to option holders	4	17,105	-	382,105	-
Travel		20,691	162,192	210,461	467,654
Income tax on foreign income		7,115	-	96,925	-
Listing and filing expense		16,372	46,722	60,104	250,676
Bank charges		15,130	43,283	37,763	92,907
Write down of projects		-	620,898	-	724,803
New project evaluation		207,592	-	295,596	-
Depreciation of equipment		6,003	7,192	19,063	17,440
		<u>1,208,487</u>	<u>2,522,263</u>	<u>4,293,788</u>	<u>9,557,402</u>
		(1,151,833)	(2,518,648)	(3,875,221)	(9,447,183)
Foreign currency translation loss (gain)		609,599	69,322	356,349	360,398
Share of loss in Tlou		187,519	320,493	931,418	2,142,178
Decrease (increase) in unrealized appreciation on investments		(236,663)	1,182,444	941,030	827,740
Accretion of present value on long term assets		-	(198,439)	(47,022)	(198,439)
Gain on sale of projects		-	(989,000)	(89,119)	(989,000)
Gain on sale of equipment		(911,395)	-	(911,395)	-
Loss (gain) on disposal of assets held for sale		-	-	-	(1,717)
Gain on sale of investments	5	-	-	-	(262,185)
		<u>(350,940)</u>	<u>384,820</u>	<u>1,181,260</u>	<u>1,878,975</u>
Net loss for the period from continuing operations		(800,893)	(2,903,468)	(5,056,481)	(11,326,158)
Net gain from discontinued operations		-	458,572	-	(962,391)
Net loss for the period		(800,893)	(2,444,896)	(5,056,481)	(12,288,549)
Share of other comprehensive income (loss) - Tlou		(162,855)	(325,792)	(91,067)	(323,619)
Net loss and comprehensive loss for the period		\$ (963,748)	\$ (2,770,688)	\$ (5,147,548)	\$ (12,612,168)
Net gain (loss) from discontinued operations attributable to:					
Shareholders of Talon		\$ -	\$ 889,519	\$ -	\$ 235,303
Non-controlling interest in Rio Verde		-	(430,947)	-	(1,197,694)
		<u>\$ -</u>	<u>\$ 458,572</u>	<u>\$ -</u>	<u>\$ (962,391)</u>
Net loss attributable to:					
Shareholders of Talon		\$ (800,893)	\$ (2,013,948)	\$ (5,056,481)	\$ (11,090,855)
Non-controlling interest in Rio Verde		-	(430,947)	-	(1,197,694)
		<u>\$ (800,893)</u>	<u>\$ (2,444,896)</u>	<u>\$ (5,056,481)</u>	<u>\$ (12,288,549)</u>
Basic and diluted loss per share from:					
Continuing operations	10	\$ (0.01)	\$ (0.03)	\$ (0.05)	\$ (0.13)
Discontinued operations		\$ -	\$ -	\$ -	\$ (0.01)
Continuing and discontinued operations		<u>\$ (0.01)</u>	<u>\$ (0.03)</u>	<u>\$ (0.05)</u>	<u>\$ (0.14)</u>
Basic and diluted loss per share from discontinued operations attributable to:					
Shareholders of Talon	10	\$ -	\$ 0.01	\$ -	\$ -
Non-controlling interest in Rio Verde		\$ -	\$ -	\$ -	\$ (0.01)

See accompanying notes to the condensed consolidated interim financial statements.

Talon Metals Corp.

Condensed Consolidated Interim Statements of Changes in Equity

(Expressed in Canadian Dollars)

(Unaudited)

	Notes	Capital stock		Common share purchase warrants	Subscription receipts	Contributed surplus	Accumulated other comprehensive loss	Deficit	Sub-total equity	Non-controlling interest in Rio Verde	Total equity
		Number of shares	Amount								
Balance at January 1, 2012		92,001,687	\$68,501,013	\$ 5,546,292	\$ -	\$13,577,709	\$ (723,363)	\$ (27,158,469)	\$ 59,743,182	\$ -	\$59,743,182
Options exercised		75,000	59,230			(29,250)			29,980		29,980
Share-based payments	9					615,631			615,631		615,631
Share of other comprehensive income - Tlou							(91,067)		(91,067)		(91,067)
Net loss								(5,056,481)	(5,056,481)		(5,056,481)
Balance at September 30, 2012	8	92,076,687	\$68,560,243	\$ 5,546,292	\$ -	\$14,164,090	\$ (814,430)	\$ (32,214,950)	\$ 55,241,245	\$ -	\$55,241,245
Balance at January 1, 2011		74,609,275	\$41,990,775	\$ 1,388,815	\$ -	\$ 7,864,955	\$ (37,918)	\$ (12,763,346)	\$ 38,443,281	\$ 13,355,970	\$51,799,251
Options exercised		569,650	447,768			(220,944)			226,824		226,824
Warrants exercised		5,323,162	4,582,712	(1,388,815)					3,193,897		3,193,897
Share issuance on financing		11,274,600	21,156,676	7,593,533					28,750,209		28,750,209
Broker warrants issued on financing			(643,150)	643,150					-		-
Compensation									-	481,100	481,100
Subscription receipts issued on financing					10,414,261				10,414,261		10,414,261
Share of other comprehensive income - Tlou							(323,619)		(323,619)		(323,619)
Broker fees and other costs on financing			(1,397,925)	(501,742)					(1,899,667)		(1,899,667)
Share based payment						5,493,537			5,493,537		5,493,537
Share issuance by Rio Verde								285,977	285,977	1,169,023	1,455,000
Net loss								(11,090,855)	(11,090,855)	(1,197,694)	(12,288,549)
Distribution of Rio Verde shares:											
Dividend								(11,460,791)	(11,460,791)		(11,460,791)
Net deconsolidation effect on equity					(10,414,261)			9,862,385	(551,876)	(13,808,399)	(14,360,275)
Balance at September 30, 2011		91,776,687	\$66,136,856	\$ 7,734,941	\$ -	\$13,137,548	\$ (361,537)	\$ (25,166,630)	\$ 61,481,178	\$ -	\$61,481,178

See accompanying notes to the condensed consolidated interim financial statements.

Talon Metals Corp.
Condensed Consolidated Interim Statements of Cash Flows

(Expressed in Canadian Dollars)

(Unaudited)

	Nine months ended September 30	
	2012	2011
Cash flows from operating activities		
Net loss for the period	\$ (5,056,481)	\$ (11,326,158)
Adjustments to reconcile net loss to net cash flows:		
Non-cash adjustments:		
Share-based payments	615,631	5,493,537
Write down of projects	-	724,803
Share of net loss in Tlou	931,418	2,142,178
Gain on sale of investments	(89,119)	(262,185)
Gain on sale of projects	-	(1,089,158)
Gain on sale of equipment	(911,395)	-
Decrease (increase) in unrealized appreciation on investments	941,030	827,740
Gain on sale and disposal of assets held for sale	-	(1,717)
Accretion of present value on long term assets	(47,022)	(198,439)
Depreciation of equipment	19,063	17,440
	<u>(3,596,875)</u>	<u>(3,671,959)</u>
Working capital adjustments:		
Decrease (increase) in prepayments	(50,198)	61,519
Decrease (increase) in accounts and other receivables	151,183	616,020
Increase (decrease) in accounts payables and accrued liabilities	(121,188)	(305,159)
	<u>(3,617,078)</u>	<u>(3,299,579)</u>
Cash flows from continuing operations	(3,617,078)	(3,299,579)
Cash flows from discontinued operations	-	(1,398,732)
	<u>(3,617,078)</u>	<u>(4,698,311)</u>
Cash flows from investing activities		
Proceeds on sale (acquisition) of equipment	4,662	(23,595)
Proceeds from sale of assets held for sale	-	1,346,154
Proceeds on sale of project	-	2,514,881
Proceeds on sale of equipment	911,395	-
Investment in Rio Verde subscription receipts	-	(500,500)
Proceeds on maturity of term deposit	-	3,503,928
Cash balance deconsolidated on distribution of Rio Verde shares		(13,356,080)
Proceeds on sale of investments	582,761	1,366,335
Acquisition of resource properties and deferred expenditures	(2,435,970)	(11,233,827)
	<u>(937,152)</u>	<u>(16,382,704)</u>
Cash flows from operations	(937,152)	(16,382,704)
Cash flows from discontinued operations	-	(5,011,437)
	<u>(937,152)</u>	<u>(21,394,141)</u>
Cash flows from financing activities		
Proceeds from exercise of options	30,000	226,824
Proceeds from exercise of warrants	-	3,193,857
Proceeds from private placements	-	26,850,542
	<u>30,000</u>	<u>30,271,223</u>
Cash flows from continuing operations	30,000	30,271,223
Cash flows from discontinued operations	-	11,785,703
	<u>30,000</u>	<u>42,056,926</u>
Net cash flows from financing activities		
	<u>30,000</u>	<u>42,056,926</u>
Net increase (decrease) in cash and cash equivalents	(4,524,230)	15,964,474
Cash and cash equivalents, beginning of the period	21,570,417	12,345,677
	<u>21,570,417</u>	<u>12,345,677</u>
Cash and cash equivalents, end of the period	\$ 17,046,187	\$ 28,310,151

See accompanying notes to the condensed consolidated interim financial statements.

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

1. NATURE OF OPERATIONS

Talon Metals Corp. ("Talon" or the "Company") is a mineral exploration company focused on the exploration and development of its portfolio of iron projects in Brazil. The Company has three indirect subsidiaries incorporated in Brazil. They are Brazmin Ltda. ("Brazmin"), Talon Ferrous Mineracao Ltda. ("Ferrous") and Talon Iron Mineracao Ltda ("TIML"). The Company, through TIML and Ferrous, holds a 100% interest in the Company's only material project, the Trairao iron project (the "Trairao Project").

The Company's head office address is Craigmuir Chambers, P.O. Box 71, Road Town, Tortola, British Virgin Islands.

Subsidiaries are entities over which the Company has the power, directly or indirectly, to govern the financial and operating policies of the entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are presently exercisable or convertible, are taken into account in the assessment of whether control exists. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are deconsolidated from the date on which control ceases.

All intercompany accounts and transactions have been eliminated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

These condensed consolidated interim financial statements have been prepared in accordance with IAS 34, Interim Financial Reporting as issued by the International Accounting Standards Board ("IASB") and using the same accounting policies and methods as were used for the Company's consolidated financial statements and the notes thereto for the years ended December 31, 2011 and 2010 (the "2011 Financial Statements"). The condensed consolidated interim financial statements should be read in conjunction with the 2011 Financial Statements.

(b) Basis of preparation

The condensed consolidated interim financial statements are presented in Canadian dollars. The financial statements are prepared on the historical cost basis, except for financial instruments that are measured on fair value basis.

(c) Share-based payments

The share option plan allows Company employees and consultants to acquire shares of the Company. The fair value of options granted is recognized as an employee or consultant expense with a corresponding increase in equity. An individual is classified as an employee when the individual is an employee for legal or tax purposes (direct employee) or provides services similar to those performed by a direct employee, including directors of the Company. The fair value is measured at grant date and each tranche is recognized on a graded basis over the period during which the options vest. The fair value of the options granted is measured using the Black-Scholes option pricing model taking into account the terms and conditions upon which the options were granted. At the end of each reporting period, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest.

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

(d) Deferred taxes

The Company uses the asset and liability method of accounting for income taxes, under which deferred income tax assets and liabilities are recognized for the estimated future income tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases. Deferred income tax assets and liabilities are measured using income tax rates in effect for the period in which those temporary differences are expected to be recovered or settled. The effect on deferred income tax assets and liabilities of a change in income tax rates or laws is recognized as part of the provision for income taxes in the period the changes are considered substantively enacted.

Deferred income tax benefits attributable to these differences, if any, are recognized to the extent that the realization of such benefits is probable.

(e) Equipment

Equipment is carried at cost, less accumulated depreciation and accumulated impairment losses. The cost of an item of equipment consists of the purchase price, any costs directly attributable to bringing the asset to the location and condition necessary for its intended use and an initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. An item of 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 equipment comprises major components with different useful lives, the components are accounted for as separate items of equipment. Expenditures incurred to replace a component of an item of equipment that is accounted for separately, including major inspection and overhaul expenditures are capitalized.

The Company provides for depreciation of its equipment at the following annual rate:

Office and computer equipment	20% straight line basis
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(f) Assets held for sale

Long-lived assets are classified as held for sale when certain criteria are met, which include: the Company's commitment to a plan to sell the assets; the assets are available for immediate sale in their present condition; an active program to locate buyers and other actions to sell the assets have been initiated; the sale of the assets is probable and their transfer is expected to qualify for recognition as a completed sale within one year; the assets are being actively marketed at reasonable prices in relation to their fair value; and it is unlikely that significant changes will be made to the plan to sell the assets or that the plan will be withdrawn.

The Company measures assets held for sale at the lower of carrying amount or fair value less cost to sell. These assets are not depreciated.

(g) Resource properties and deferred exploration and evaluation costs

Interests in mineral exploration properties are recorded at cost. Exploration expenditures, other than those of a general nature, relating to mineral properties in which an interest is retained are deferred and carried as an asset until the results of the projects are known. If the project is unsuccessful or if exploration has ceased because continuation is not economically feasible, the cost of the property and the related exploration expenditures are written off.

The cost of mineral properties includes the cash consideration and the negotiated value of shares issued on the acquisition of properties. Properties acquired under option agreements, whereby option payments are made at the discretion of the company, are recorded in the financial statements at the time payments are made; however, certain option payments that management has determined are likely to be made, have been accrued in the financial statements. The proceeds from options granted on properties are credited to the cost

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

of the related property.

Once the feasibility of a project has been established, deferred exploration expenses and other costs are segregated as deferred development expenditures. These costs are amortized over the estimated useful life of the related mineral property as commercial production commences. If the net carrying amount of the deferred exploration expenses is not recoverable, these costs are written down to net recoverable amount of the deferred exploration expense.

The amounts shown for mineral properties and deferred exploration costs represents cost to date, and do not necessarily represent present or future values as they are entirely dependent upon the economic recovery of future reserves.

The Company does not accrue the estimated future costs of maintaining its mineral properties in good standing.

(h) Impairment of non-financial assets

At the end of each reporting period the carrying amounts of the Company's non-financial assets are reviewed to determine whether there is any indication that those assets have suffered an impairment loss. Where such an 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 order to determine fair value, the Company considers multiple valuation approaches, including the income, market and cost approaches. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax 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 the profit or loss for the period. For the purposes of impairment testing, exploration and evaluation assets are allocated to cash-generating units to which the exploration activity relates. 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 loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount 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.

(i) Foreign currencies

Functional and presentation currency

The Canadian dollar is the functional currency and reporting currency of the Company.

The consolidated financial statements are presented in Canadian dollars. Monetary items are translated into Canadian dollars at the rate of exchange in effect at the end of the reporting period. Revenues and expenses are translated into Canadian dollars at the rates of exchange prevailing when the underlying transactions occurred.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated statements of loss and comprehensive loss.

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

(j) Financial assets and liabilities

Financial instruments are measured on initial recognition at fair value, plus, in the case of financial instruments other than those classified as "fair value through profit and loss", directly attributable transaction costs. Measurement of financial assets in subsequent periods depends on whether the financial instrument has been classified as "fair value through profit and loss", "available-for-sale", "held-to-maturity", or "loans and receivables" as defined by IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). Measurement of financial liabilities subsequent to initial recognition depends on whether they are classified as fair value through profit and loss or "other financial liabilities".

Financial assets and financial liabilities at fair value through profit and loss include financial assets and financial liabilities that are held for trading or designated upon initial recognition as fair value through profit and loss. These financial instruments are measured at fair value with changes in fair values recognized in the consolidated statements of loss and comprehensive loss. Financial assets classified as available-for-sale are measured at fair value, with changes in fair values recognized in other comprehensive income ("OCI"), except when there is objective evidence that the asset is impaired, at which point the cumulative loss that had been previously recognized in OCI is recognized within the consolidated statements of loss and comprehensive loss. Financial assets classified as held-to-maturity and loans and receivables are measured subsequent to initial recognition at amortized cost using the effective interest method. Financial liabilities, other than financial liabilities classified as fair value through profit and loss, are measured in subsequent periods at amortized cost using the effective interest method.

The Company has classified its financial instruments as follows:

Cash	-	Fair value through profit and loss
Term deposits	-	Fair value through profit and loss
Investments	-	Fair value through profit and loss
Accounts and other receivables	-	Loans and receivables
Accounts payable	-	Other liabilities

Financial instruments recorded at fair value on the consolidated balance sheets are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);
- Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

At September 30, 2012, cash and cash equivalents, term deposits and investment in marketable securities have been measured using level 1 inputs. The investment in share purchase warrants of publicly traded companies has been measured using level 2 inputs (refer to Note 5(a) for a summary of the inputs used in the Black-Scholes calculation). The provision in respect of the Rio Verde shares to be distributed to certain option holders, has been measured using level 1 and level 3 inputs.

Impairment of financial assets:

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

Objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organization.

For certain categories of financial assets, such as amounts receivable, assets that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of amounts receivable, where the carrying amount is reduced through the use of an allowance account. When an amount receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss. In a subsequent period, if the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

(k) Cash and cash equivalents

Cash and cash equivalents consist of cash deposits in banks, certificates of deposit and short-term investments with remaining maturities of three months or less at time of acquisition.

(l) Investments in associates

The Company accounts for its investments in companies over which it has significant influence using the equity basis of accounting whereby the investments are initially recorded at cost and subsequently adjusted to recognize the Company's share of earnings or losses of the investee companies and reduced by dividends received, if any. Carrying values of investments are reviewed for indicators of impairment and written down to estimated fair values if there is evidence of impairment. Such impairment would be recorded in the consolidated statements of operations.

(m) Asset retirement obligations

A provision is recognized in the statement of financial position when the Company has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. The Company's asset retirement obligations arise from its obligations to undertake site reclamation and remediation in connection with its resource properties. The estimated costs of reclamation are based on current regulatory requirements and the estimated reclamation costs at the date of purchase. Future changes to those regulations and standards, as well as changes resulting from operations may result in actual reclamation costs differing from the estimate.

(n) Interest and other income

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable. The proceeds from options granted on properties are credited to the cost of the related property, but where the proceeds exceed the property's carrying value, any excess proceeds are credited to income.

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

(o) Loss per share

Basic loss per common share is calculated by dividing the loss attributed to shareholders for the period by the weighted average number of common shares outstanding in the period. Diluted loss per common share is calculated by adjusting the weighted average number of common shares outstanding to assume conversion of all dilutive potential common shares.

(p) Segment reporting

A segment is a component of the Company that is distinguishable by economic activity (business segment), or by its geographical location (geographical segment), which is subject to risks and rewards that are different from those of other segments. The Company operates in one business segment, namely, mineral exploration.

(q) Future changes in accounting policies

IFRS 7 Financial Instruments: Amendment regarding Offsetting Financial Assets and Financial Liabilities. This amendment enables users of the financial statements to better compare financial statements prepared in accordance with IFRS and US Generally Accepted Accounting Principles. The Company will start the application of IFRS 7 in the financial statements effective from January 1, 2013. The Company does not expect any impact to the financial statements as a result of adopting this standard.

IFRS 9 Financial Instruments: This standard replaces the current IAS 39 Financial Instruments Recognition and Measurement. The standard introduces new requirements for classifying and measuring financial assets and liabilities. The Company will start the application of IFRS 9 in the financial statements effective from January 1, 2013. The Company has not yet evaluated the impact on the financial statements.

IFRS 10 Consolidated Financial Statements: This standard replaces the current IAS 27 Consolidated and Separate Financial Statements. The standard identifies the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The Company will start the application of IFRS 10 in the financial statements effective from January 1, 2013. The Company does not expect any impact to the financial statements as a result of adopting this standard.

IFRS 12 Disclosure of Interests in Other Entities: This standard requires disclosures relating to an entity's interests in subsidiaries. The Company will start the application of IFRS 12 in the financial statements effective from January 1, 2013. The Company does not expect any impact to the financial statements as a result of adopting this standard.

IFRS 13 Fair Value Measurements: This standard defines fair value, provides guidance on its determination and introduces consistent requirements for disclosures on fair value measurements. The Company will start the application of IFRS 13 in the financial statements effective from January 1, 2013. The Company has not yet evaluated the impact on the financial statements.

IAS 1 Presentation of Financial Statements: The standard provides guidance on the presentation of items of other comprehensive income ("OCI") and their classification within OCI. The Company will start the application of this standard in the financial statements effective from January 1, 2013. The Company does not expect any impact to the financial statements as a result of adopting this standard.

IAS 32 Financial Instruments; Offsetting Financial Assets and Financial Liabilities: The amendment provides further clarification on the application of the offsetting requirements. The Company will start the application of IAS 32 in the financial statements effective from January 1, 2014. The Company has not yet evaluated the impact on the financial statements.

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

3. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these estimates. The consolidated financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and the revision affects both current and future periods.

Significant assumptions about the future and other sources of estimation uncertainty that management has made at the statement of financial position dates and for the periods then ended, that could result in a material adjustment to the carrying amounts of assets and liabilities, in the event that actual results differ from assumptions made, relate to, but are not limited to, the valuation of resource properties.

4. ACQUISITIONS AND SPIN OFF

Acquisition of Rio Verde Shares

On December 10, 2010, Talon entered into an agreement with Rio Verde Minerals Corporation, at that time a private Brazilian focused fertilizer company, pursuant to which Talon transferred to Rio Verde Minerals Corporation all of Talon's rights in the Sergipe Potash Project licenses in return for approximately 26.6 million shares of Rio Verde Minerals Corporation (representing approximately 54% of the shares in Rio Verde Minerals Corporation).

The Company assessed that control existed over Rio Verde (defined below), and as such Rio Verde was fully consolidated until July 27, 2011.

Distribution of Rio Verde Shares

On July 28, 2011, Talon distributed most of its shares of Rio Verde Minerals Development Corp. ("Rio Verde"), the resulting Toronto Stock Exchange listed entity, to Talon shareholders (the "RV Distribution"). Talon shareholders of record at the close of business on July 27, 2011 received one ordinary share of Rio Verde for every four shares of Talon held.

The remaining shares in Rio Verde were retained, to be distributed in most part, to Talon option holders as of July 27, 2011, upon the future exercise by them of their options, on the basis of one ordinary share of Rio Verde for every four Talon options exercised. A provision of \$361,365 has been recognized for this purpose in the statements of loss and comprehensive loss, for the nine month period ended September 30, 2012. This provision has been based on the closing share price of Rio Verde as at September 30, 2012 and a probability adjustment to take into account that certain options are out-of-the-money.

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

5. INVESTMENTS

(a) Temporary investments

	September 30, 2012			December 31, 2011		
	Number	Price	Value	Number	Price	Value
Lago Dourado Minerals Ltd. shares	500,000	0.32	\$ 160,000	500,000	0.36	\$ 177,500
Lago Dourado Minerals Ltd. warrants	-	-	-	500,000	0.08	40,500
Brazilian Gold Corporation shares	3,191,489	0.23	734,043	1,147,967	0.43	493,622
Rio Verde Minerals Corporation shares	3,370,427	0.29	977,424	3,467,927	0.30	1,040,378
Rio Verde Minerals Corporation warrants	770,000	0.09	67,807	770,000	0.19	146,300
			<u>\$ 1,939,274</u>			<u>\$ 1,898,300</u>

The Company held 500,000 warrants in Lago Dourado Minerals Ltd. which expired on July 13, 2012.

At December 31, 2011, the Company held a total of 1,147,967 Brazilian Gold Corporation ("Brazilian Gold") shares. All of these shares were sold by the Company during the first quarter of 2012 for gross proceeds of \$582,761. A further 3,191,489 Brazilian Gold shares were received during the first quarter of 2012 under the terms of the amended Sao Jorge sale agreement (see note 6(b)).

The Company has fair valued the Rio Verde Minerals Corporation warrants at September 30, 2012, at an amount of \$67,807 using the Black-Scholes option pricing model with the following assumptions: expected life of 3.82 years (December 31, 2011 – 4.5 years), risk-free interest rate of 1.25% (December 31, 2011 – 2.35%), dividend rate of 0% (December 31, 2011 – 0%), and volatility of 79% (December 31, 2011 – 110%). These warrants have an exercise price of \$0.85 per warrant and expire on July 27, 2016.

(b) Long term investments

Tlou Energy Limited

	<u>September 30, 2012</u>	<u>December 31, 2011</u>
Tlou Energy Limited	<u>\$ 18,593,029</u>	<u>\$ 19,615,514</u>

Effective November 30, 2010, the Company completed a transaction with Tlou Energy Limited ("Tlou Energy") in which Talon transferred to Tlou Energy all of the Company's rights in the Saber Gas Project licenses and some property, plant and equipment, in return for a 30% ownership interest in Tlou Energy valued at approximately \$21 million. The Company recognized a net gain of approximately \$3 million in the year ended December 31, 2010, relating to the licenses and equipment sale. The Company accounts for its investment in Tlou Energy using the equity method.

In October 2011, the Company took up all of its rights in a Tlou Energy rights offering acquiring another 2,571,428 shares of Tlou Energy (to add to its existing holding of 19,285,714 shares), for a cost of approximately \$1,556,000. After this transaction, the Company's share in Tlou Energy increased to 21,857,142 shares, representing approximately 31%. The Company also has the option to increase its investment by subscribing for up to an additional 4,945,055 shares of Tlou Energy at an exercise price of AUD \$1.25 each, exercisable until the later of (i) June 30, 2013, and (ii) 30 days after the options have been released from any mandatory escrow required by the Australian Securities Exchange in connection with Tlou Energy's listing.

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

The Company's investment in Tlou Energy at September 30, 2012 amounted to \$18,593,029 (December 31, 2011 - \$19,615,514) and is comprised of the initial cost of \$21,080,850, plus the cost of the shares subscribed for as part of the rights offering, less a 31% share of net loss in Tlou Energy for the period December 1, 2010 to September 30, 2012. The Company's share of Tlou Energy's net assets at the date of acquisition was approximately \$10 million.

The following is summarized financial information for Tlou Energy:

	<u>September 30, 2012</u>	<u>December 31, 2011</u>
Total assets	\$ 33,779,469	\$ 36,721,881
Total liabilities	\$ (4,521,143)	\$ (4,208,005)
	<u>Three months ended September 30, 2012</u>	<u>Three months ended September 30, 2011</u>
Revenues	\$ (16,860)	\$ (62,963)
Net loss and comprehensive loss	\$ 709,034	\$ 7,441,294
	<u>Nine months ended September 30, 2012</u>	<u>Nine months ended September 30, 2011</u>
Revenues	\$ (59,467)	\$ (95,751)
Net loss and comprehensive loss	\$ 3,298,339	\$ 6,065,042

6. RESOURCE PROPERTIES AND DEFERRED EXPENDITURES

The properties on which the Company's subsidiaries carry out exploration and development activities are located in Brazil. Details of additions and impairments for the nine month period ended September 30, 2012 are comprised as follows:

	<u>December 31, 2011</u>	<u>2012 Additions</u>	<u>September 30, 2012</u>
Mineral Properties:			
Trairao Project	\$ 14,056,824	\$ 2,269,946	\$ 16,326,770
Inaja South Project	981,965	164,978	1,146,943
Campo Grande Gold Project	528,531	1,046	529,577
	<u>\$ 15,567,320</u>	<u>\$ 2,435,970</u>	<u>\$ 18,003,290</u>

Although the Company believes it has taken reasonable measures to ensure proper title to its mineral properties in which it has an interest, there is no guarantee that title to any of its mineral properties will not be challenged or impaired. Third parties may have valid claims underlying portions of the Company's interests, including prior unregistered liens, agreements, transfers or claims, including native land claims, and title may be affected by, among other things, undetected defects. In addition, the Company may be unable to operate

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

its properties as permitted or to enforce its rights with respect to its properties.

Mineral properties

(a) Trairao Project and Inaja South Project

On September 29, 2010, Talon announced that it had acquired 100% of the rights to the Trairão Project and the Inajá South Project in Pará State, Brazil, through concluding two separate agreements with Codelco do Brasil Mineração Ltda (“Codelco”) and Barrick International (Barbados) Corp. (“Barrick Barbados”).

Under the agreement with Codelco, Talon paid Codelco a nominal purchase price and will pay a royalty of US\$0.7005 per tonne of iron mined and sold, in the event of mining in the future on the licences.

Under the agreement with Barrick Barbados, Talon paid Barrick Barbados a nominal purchase price and is obliged to pay certain production related royalties, at varying levels in respect of specific metals. In the case of the Trairão Project, the royalty payable to Barrick Barbados is US\$0.2995 per tonne of iron mined and sold. However, Talon has the right to buy back this royalty for US\$599,000 during the 12 month period following the start of commercial production. In terms of the Inajá South Project, Barrick Barbados will receive a net smelter royalty of 0.5% for any base metals sold (sales tonnes) and 1.0% for any precious metals sold (sales tonnes). Talon has the right to buy back the royalty for US\$1 million during the 12 month period following the start of commercial production. Barrick Barbados has the right to buy back up to a 50% interest in any future gold mining operation in the event that Talon completes a feasibility study with respect to a deposit which identifies reserves totalling at least three million ounces of gold.

(b) São Jorge Gold Project (see note 7)

Talon entered into an option agreement (the “São Jorge Agreement”) dated June 14, 2010 with Brazilian Gold whereby Brazilian Gold was granted an option to purchase a 100% interest in the São Jorge Gold Project. Under the São Jorge Agreement, in order to exercise the option Brazilian Gold was required to pay Talon a total of \$2,250,000 in cash and \$2,250,000 in Brazilian Gold shares (calculated as the number of Brazilian Gold shares equal to the dollar amount divided by the twenty day volume-weighted average trading price of Brazilian Gold shares) in three payments of cash and shares. As provided for under the São Jorge Agreement, Brazilian Gold made the first two payments totalling \$1.5 million in cash and \$1.5 million in Brazilian Gold shares. On February 17, 2012, the Company and Brazilian Gold entered into an amendment agreement (“São Jorge Amendment Agreement”) whereby the parties agreed that if the final option payment was made at the time of the São Jorge Amendment Agreement, Talon would accept such payment as \$1.5 million in Brazilian Gold shares, instead of \$750,000 in cash and \$750,000 in Brazilian Gold shares. Given this, Brazilian Gold has exercised the option resulting in the Company indirectly transferring to Brazilian Gold its indirect subsidiary Brazilian Resources Mineracao Ltda. which owns a 100% interest in the São Jorge Gold Project. Brazmin retains a 1% net smelter return royalty over the project.

The related project amounts were classified under Assets Held for Sale, as at December 31, 2011.

(c) Campo Grande Gold Project

The Campo Grande project is located approximately 110 km west of Belo Horizonte, the capital of Minas Gerais State, Brazil. This project consists of three exploration licenses covering 2,611 hectares, which are owned 100% by Brazmin. An NSR of 1.5% is held by a third party on one of the three licenses.

7. ASSETS HELD FOR SALE

The Company received 3,191,489 Brazilian Gold shares (valued at \$1,500,000 at the time of receipt) during the first quarter of 2012, being the final payment in respect of the “Assets held for sale” relating to the Sao Jorge Gold Project.

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

Assets held for sale are comprised of the following:

	<u>September 30, 2012</u>	<u>December 31, 2011</u>
Saber plant and equipment	\$ 262,400	\$ 262,400
Sao Jorge Gold Project	-	1,452,978
	<u>\$ 262,400</u>	<u>\$ 1,715,378</u>

8. SHARE CAPITAL AND OTHER EQUITY

(a) Authorized, issued and outstanding common shares

Authorized – 100,000,000,000 common shares, no par value

Issued and outstanding - 92,076,687 common shares at September 30, 2012, and 92,001,687 common shares at December 31, 2011.

On April 29, 2011, the Company completed a bought deal prospectus offering of 9,804,000 units (each a "Unit") at a price of \$2.55 per Unit for gross proceeds of \$25,000,200. The Underwriters exercised their full over-allotment option to acquire 1,470,600 additional Units for additional gross proceeds of \$3,750,030. In total, 11,274,600 Units were sold for gross proceeds of \$28,750,230. Each Unit consisted of one common share in the capital of the Company (each a "Common Share") and one-half of one common share purchase warrant (each whole common share purchase warrant, a "Warrant"). Each Warrant entitled the holder thereof to purchase one Common Share at a price of \$3.10 at any time up to October 29, 2012. In addition, 552,852 broker warrants were issued on April 29, 2011. These warrants expired on October 29, 2012.

The proceeds have been prorated to Common Shares and Warrants based on the relative fair value of each component, as follows: Common Shares - \$23.5 million; Warrants - \$5.2 million. The Black-Scholes option pricing model was used to determine the fair value of the Warrants using the following assumptions: expected dividend yield – nil; expected volatility –112%; risk free interest rate – 1.62%; and an expected life of eighteen months.

(b) Warrants

Common share purchase warrants transactions during the periods ended September 30, 2012 and December 31, 2011 are as follows:

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

	2012			2011		
	Number of Warrants	Weighted average exercise price	Fair Value	Number of Warrants	Weighted average exercise price	Fair Value
Outstanding – beginning of the year	6,190,152	\$3.05	\$5,546,292	5,323,163	\$0.60	\$1,388,815
Issued				5,637,300	3.10	5,250,038
Issued				552,852	2.55	643,150
Cost of issuance						(346,896)
Exercised				(5,323,163)	0.60	(1,388,815)
Outstanding – end of the period	6,190,152	\$3.05	\$5,546,292	6,190,152	\$3.05	\$5,546,292

9. SHARE-BASED PAYMENTS – EMPLOYEE SHARE OPTION PLAN

The Company has adopted a stock option plan (the "Plan") for its directors, officers, employees and consultants to acquire common shares of the Company. The exercise price of each option is determined by the board of directors of Talon but, in any event, not lower than the closing market price on the Toronto Stock Exchange on the trading day immediately preceding the date the option is granted. The terms and conditions of the options are determined by the board of directors of the Company pursuant to the rules of the Plan. All options are granted for a term not exceeding ten years from the grant date. The total number of options that can be granted is limited to 12.5% of the issued and outstanding share capital of the Company.

A summary of the status of the options outstanding as at September 30, 2012 and as at December 31, 2011 and changes during the periods ended on those dates is presented below:

	September 30, 2012		December 31, 2011	
	Number of stock options	Weighted average exercise price	Number of stock options	Weighted average exercise price
Outstanding – beginning of the year	9,489,350	\$ 1.00	6,739,000	\$ 0.45
Granted	2,800,000	0.45	1,485,000	1.93
Granted	465,408	0.37	2,085,000	1.95
Granted	1,279,592	0.42	250,000	1.00
Granted	400,000	0.33		
Cancelled	(500,000)	0.40	(50,000)	0.70
Cancelled	(430,000)	1.58	(150,000)	1.58
Cancelled	(890,000)	1.95	(45,000)	1.95
Cancelled	(60,000)	0.70	(30,000)	2.48
Exercised	-	-	(109,500)	0.39
Exercised	(75,000)	0.40	(685,150)	0.40
Outstanding – end of the period	12,479,350	\$ 0.71	9,489,350	\$ 1.00

1,733,733 of the 12,479,350 options outstanding have been issued outside of the Company's Plan.

As at September 30, 2012, the Company had the following stock options outstanding:

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

<u>Date of grant</u>	<u>Number of options</u>	<u>Exercisable</u>	<u>Exercise price</u>	<u>Expiry date</u>
February 18, 2008	200,000	200,000	\$0.57	February 18, 2013
June 11, 2009	490,000	490,000	\$0.385	June 11, 2014
May 21, 2010	3,669,350	3,669,350	\$0.40	May 21, 2015
October 26, 2010	900,000	900,000	\$0.70	October 26, 2015
January 17, 2011	305,000	305,000	\$1.58	January 17, 2016
February 7, 2011	70,000	70,000	\$2.12	February 7, 2016
March 3, 2011	500,000	500,000	\$2.48	March 3, 2016
May 25, 2011	1,150,000	1,150,000	\$1.95	May 25, 2016
October 1, 2011	250,000	250,000	\$1.00	October 1, 2016
January 31, 2012	2,800,000	700,000	\$0.45	January 31, 2017
April 4, 2012	1,279,592	491,828	\$0.415	April 4, 2017
April 25, 2012	465,408	30,672	\$0.37	April 25, 2017
June 15, 2012	400,000	100,000	\$0.33	June 15, 2017
	12,479,350	8,856,850		

A share-based payment cost of \$615,631 for the options vested in the nine months ended September 30, 2012 (2011 – \$5,493,537) was recognized in the consolidated statements of loss and comprehensive loss for that period.

In January 2012, 2.8 million options were issued to the new CEO of the Company. These have a contractual life of 5 years and an exercise price of \$0.45. They vest as follows: 700,000 vested on February 9, 2012, 700,000 on the earlier of 12 months from the date of grant or the date that the 5 day volume weighted average trading price (“VWAP”) is at least \$1.00, 700,000 on the earlier of 18 months from the date of grant or the date that the VWAP is at least \$1.50 and 700,000 on the earlier of 24 months from the date of grant or the date that the VWAP is at least \$2.00.

In April 2012, 1,279,592 options were issued to certain of the officers, employees and consultants of the Company. These have a contractual life of 5 years and an exercise price of \$0.415. They vest as follows: 491,828 vested on April 4, 2012, 157,500 on the earlier of April 1, 2013 or the date that the VWAP is at least \$1.00 and 146,973 on the earlier of October 1, 2013, or the date that the VWAP is at least \$1.50. In addition, 250,000 options vest on the earlier of March 20, 2013 or the date that the VWAP is at least \$1.00 and another 233,291 options vest on the earlier of September 20, 2013, or the date that the VWAP is at least \$1.50.

Also in April 2012, 465,408 options were issued to certain of the officers, employees and consultants of the Company. These have a contractual life of 5 years and an exercise price of \$0.37. They vest as follows: 30,672 vested on April 25, 2012, 10,527 will vest on the earlier of October 1, 2013 or the date that the VWAP is at least \$1.50 and 157,500 on the earlier of April 1, 2014 or the date that the VWAP is at least \$2.00. In addition, 16,709 options vest on the earlier of September 20, 2013 or the date that the VWAP is at least \$1.50 and another 250,000 options vest on the earlier of March 20, 2014, or the date that the VWAP is at least \$2.00.

In June 2012, 400,000 options were issued to the new CFO of the Company. These have a contractual life of 5 years and an exercise price of \$0.33. They vest as follows: 100,000 vested on June 15, 2012, 100,000 on the earlier of 12 months from the date of grant or the date that the VWAP is at least \$1.00, 100,000 on the earlier of 18 months from the date of grant or the date that the VWAP is at least \$1.50 and 100,000 on the earlier of 24 months from the date of grant or the date that the VWAP is at least \$2.00.

During 2011, the Company issued options to certain of its officers, directors, employees and consultants, of

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

which some vested and some were cancelled as follows:

- February 2011 - 70,000 options with an exercise price of \$2.12 which vested on the date of grant and have a life of 5 years.
- March 2011 - 530,000 options with an exercise price of \$2.48 which vested on the date of grant and have a life of 5 years.
- May 2011 - 2,085,000 options with an exercise price of \$1.95 and a life of 5 years. Other than as hereinafter provided, the May 2011 options vested immediately. 1,000,000 of the May 2011 options were to vest in equal amounts after 6 months, 12 months, 18 months and 24 months from the date of grant. In the first quarter of 2012, the options that were due to vest after 12 months, vested immediately and the options that were due to vest 18 and 24 months after the date of grant were cancelled. In addition, 150,000 of the May 2011 options were subject to vesting. 50,000 of these options vested immediately, 50,000 vested after 6 months, and 50,000 were to vest after 12 months. All 150,000 of these options were cancelled in January 2012.
- October 2011 – 250,000 options with an exercise price of \$1.00 and a life of 5 years. They vest in equal amounts after 6 and 12 months from the date of grant.

The fair value of the options granted was determined using the Black-Scholes option pricing model, using the following range of assumptions:

	<u>2012</u>	<u>2011</u>
Risk-free interest rate	1.4%	1.4%
Expected life	5 years	5 years
Expected volatility	102-111%	215-235%
Dividend yield	Nil	Nil

10. LOSS PER SHARE

(a) Basic

Basic loss per share is calculated by dividing the net loss attributable to common shareholders by the weighted average number of common shares in issue during the period.

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

Continuing operations:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net loss attributable to common shareholders	\$ (800,893)	\$ (2,903,468)	\$ (5,056,481)	\$ (11,326,158)
Weighted average number of common shares on issue	92,001,687	91,746,361	92,001,687	85,496,007
Basic loss per share	\$ (0.01)	\$ (0.03)	\$ (0.05)	\$ (0.13)

Discontinued operations:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net gain (loss) from discontinued operations	\$ -	\$ 458,572	\$ -	\$ (962,391)
Weighted average number of ordinary shares on issue	92,001,687	91,746,361	92,001,687	85,496,007
Basic earnings (loss) per share from discontinued operations	\$ -	\$ 0.00	\$ -	\$ (0.01)

(b) Diluted

Diluted loss per share has not been presented as this is anti-dilutive.

11. FINANCIAL INSTRUMENTS

The Company's financial instruments include cash and cash equivalents, term deposits, accounts and other receivables, investments and accounts payable and accrued liabilities. The fair value of these financial instruments approximates carrying value.

Fair Value Hierarchy

The fair value hierarchy establishes three levels to classify inputs to the valuation techniques used to measure fair value. Level 1 inputs are quoted market prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly, such as prices, or indirectly (derived from prices). Level 3 inputs are unobservable (supported by little or no market activity), such as non-corroborative indicative prices for a particular instrument provided by a third party.

The Company has classified the above financial assets and liabilities as follows:

Level 1	
Cash and cash equivalents	\$17,046,187
Investments	\$1,939,274
Level 2	
Rio Verde warrants (included in investments)	\$67,807
Level 3	
Provision for distribution of Rio Verde shares to option holders	\$361,365

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

12. FINANCIAL RISK MANAGEMENT

(a) Credit risk management

Certain of the Company's financial assets are exposed to a degree of credit risk. The Company endeavors to mitigate credit risk by holding its cash and cash equivalents as cash deposits, short-term government treasury bills, money market funds and GIC's with major commercial banks.

Credit risk relating to accounts receivable arises from the possibility that any counterparty to an instrument fails to perform. The Company does not feel there is significant counterparty risk that could have an impact on the fair value of cash and cash equivalents and receivables.

(b) Liquidity risk

The Company has in place a planning and budgeting process to help determine the funds required to support the Company's normal operating requirements on an ongoing basis and its capital, development and exploration expenditures. The Company ensures that there are sufficient funds to meet its short-term requirements, taking into account its anticipated cash flows from operations and its holdings of cash and cash equivalents.

As of September 30, 2012, the Company had a cash balance of \$17,046,187 (December 31, 2011 - \$21,570,417) to settle current accounts payable and accrued liabilities of \$954,422 (December 31, 2011 - \$1,100,003).

(c) Market risk

Market risk is the risk that changes in market prices including foreign exchange rates and interest rates will affect the Company's income or the value of its financial instruments. The Company records its investments using the bid price at the end of the reporting period. Changes in the bid price will affect the fair value of these investments. A 5% change in the value of its investments, would have affected net loss of the Company for the nine months ended September 30, 2012, by about \$96,964.

(d) Foreign exchange risk

The Company is exposed to movements in the United States Dollar and the Brazilian Real as transfers are made to the Brazilian subsidiaries of the Company in United States Dollars and subsequently converted in Brazil to Brazilian Reals.

At September 30, 2012, the Company had net monetary assets and liabilities in foreign currencies, as follows (Canadian dollar equivalent):

United States dollars	\$6,534,760
Brazilian Real	\$224,654

If foreign exchange rates changed by 5%, there would be a change in the net loss of the Company for the nine months ended September 30, 2012 of approximately \$318,512.

The Company does not undertake currency hedging activities.

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

(e) Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The risk of investing cash equivalents into fixed interest rate investments is mitigated by the short terms in which these investments mature. The Company is exposed to interest rate risk only to the extent of its interest income on Treasury bills and money market funds. These are typically short-term investments with a term of less than ninety days. The Company has no interest bearing debt.

13. CAPITAL RISK MANAGEMENT

Capital is comprised of equity which at September 30, 2012 was \$55,241,244 (December 31, 2011 - \$59,743,182). The Company manages its capital structure and makes adjustments to it, in order to have the funds available to support its exploration, development and operations activities.

The Company's objective when managing capital is to safeguard the Company's ability to continue as a going concern in order to pursue the exploration of its mineral properties and maximize shareholder returns. The Company satisfies its capital requirements through careful management of its cash resources and by utilizing bank indebtedness or equity issues, as necessary, based on the prevalent economic conditions of both the industry and the capital markets and the underlying risk characteristics of the related assets. As at September 30, 2012, the Company had no bank debt.

Management reviews its capital management approach on an ongoing basis. There were no changes in the Company's approach to capital management during the nine months ended September 30, 2012. The Company is not subject to externally imposed capital requirements.

14. RELATED PARTY TRANSACTIONS

Related parties include the board of directors of the Company, close family members and enterprises which are controlled by these individuals as well as certain persons performing similar functions.

Effective April 1, 2011, the Company entered into a revised administrative and advisory services agreement (the "**Tau Agreement**") with Tau Capital Corp. ("**Tau**"). Warren Newfield and Greg Kinross, both directors of Talon are also directors of Tau. Under the Tau Agreement, Talon agreed to pay Tau a monthly service fee of \$58,500. Effective April 1, 2012, the parties agreed to lower the monthly service fee to \$25,000, given that Tau would be providing less direct services to Talon. On June 1, 2012, the Tau Agreement was terminated by the parties. For the three months ended September 30, 2012, fees paid to Tau for these services were \$Nil (2011 - \$175,500). For the nine months ended September 30, 2012, fees paid for these services were \$225,500 (2011-\$450,000).

Effective April 1, 2011, Talon entered into a services agreement with a company owned by an officer and director of Talon (Luis Azevedo) (the "**Brazil Agreement**"). Pursuant to the Brazil Agreement, the company provides Talon with certain accounting, legal and general administrative functions in Brazil. The Brazil Agreement had an initial term of one year and automatically renewed for an additional one year term and will continue to do so until it is terminated in accordance with its terms. Under the Brazil Agreement, Talon agreed to pay a monthly service fee of US\$33,000. Effective May 1, 2012, the parties agreed to lower the monthly service fee to US\$23,000 and, on October 1, 2012, the parties agreed to further lower the monthly service fee to US\$18,000. Coupled with the revised fee in October 2012, the parties agreed to a one year term for the Brazil agreement. For the three months ended September 30, 2012, fees paid were \$68,266 (2011 - \$96,822). For the nine months ended September 30, 2012 fees paid amounted to \$256,266 (2011 - \$254,575).

Consulting fees paid to officers of the Company (Luis Azevedo and Stuart Comline) for the three months ended September 30, 2012 were \$82,500 (2011 - \$179,958 including Eddie Scholtz). Consulting fees paid to officers of the Company (Luis Azevedo and Stuart Comline) for the nine months ended September 30, 2012 were

Talon Metals Corp.

Notes to the Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2012 and 2011

(Expressed in Canadian dollars)

\$247,500 (2011 - \$337,493 including Eddie Scholtz).

Accounts payable at September 30, 2012 include \$30,900 payable to an officer of the Company (Luis Azevedo) for consulting fees (2011 - \$15,000).

The remuneration of directors and officers of the Company for the three and nine months ended September 30, 2012 and 2011 were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Aggregate compensation	\$ 533,891	\$ 179,958	\$ 1,501,649	\$ 1,351,827
Share based compensation - included in line above	\$ 204,516	\$ -	\$ 494,988	\$ 815,334

Certain officers of the Company were awarded the following share options during the nine months ended September 30, 2012:

Date of grant	Number of options	Exercise price	Expiry
January 31, 2012	2,800,000	\$0.45	January 31, 2017
April 4, 2012	975,277	\$0.42	April 4, 2017
April 25, 2012	354,723	\$0.37	April 25, 2017
June 15, 2012	400,000	\$0.33	June 15, 2017

15. GEOGRAPHIC INFORMATION

Interest income is earned in Canadian dollars, United States dollars and Brazilian Real. Almost all of the Company's equipment (excluding the assets of Tlou Energy which is not discussed here, as it is equity accounted for), is in Brazil and all of the mineral properties are located in Brazil.