

SPROTT INC.

NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended June 30, 2010 and 2009

1. CORPORATE ACTIVITIES

Sprott Inc. (the “Company”) was incorporated under the Business Corporations Act (Ontario) on February 13, 2008. The Company was incorporated to acquire, through an exchange of shares, all of the shares of Sprott Asset Management Inc. (“SAMI”).

On May 8, 2008, the Company filed a prospectus (“Prospectus”) in each of the provinces and territories of Canada in respect of the initial public offering of 20 million common shares to be effected via a secondary offering by certain shareholders of the Company (the “Offering” or “IPO”). Common shares of the Company are traded on the Toronto Stock Exchange (“TSX”) under the symbol SII.

On June 1, 2009, SAMI completed a corporate reorganization and transferred its discretionary portfolio management business to Sprott Asset Management LP (“SAM LP”) and its broker dealer services to Sprott Private Wealth LP (“SPW LP”). After the reorganization, SAMI was wound up into the Company. As a result of the reorganization, the Company is now the sole limited partner of SAM LP, SPW LP and Sprott Consulting LP (“SCLP”). The reorganization had no impact on the consolidated financial statements. SAM LP is a portfolio manager and exempt market dealer and SPW LP is an investment dealer and a member of the Investment Industry Regulatory Organization of Canada (“IIROC”). SPW LP has a Type II introducing broker agreement with Cormark Securities Inc. (“Cormark”). Under the terms of the agreement, Cormark performs trading, clearing, segregation/safekeeping and recordkeeping services for SPW LP. SCLP provides management and administrative services to other companies.

2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (“GAAP”) and include the accounts of the Company, its wholly owned subsidiaries as well as three limited partnerships in which the Company is the sole limited partner. The three limited partnerships are SAM LP, SPW LP and SCLP while the material wholly owned subsidiaries are Sprott Genpar Ltd., SAMGENPAR Ltd., Sprott Power Consulting LP and Sprott 2010 Corporation. All intercompany accounts are eliminated on consolidation.

Certain information and note disclosures normally included in the annual financial statements have been condensed or excluded. As a result, these unaudited interim consolidated financial statements do not contain all disclosures required for annual financial statements and should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto for the year ended December 31, 2009. All material adjustments which, in the opinion of management, are necessary for fair presentation of the results of the interim periods have been reflected in these consolidated financial statements. The results of operations for the three and six months ended June 30, 2010 are not necessarily indicative of the results to be expected for the full year.

Use of estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results may vary from the current estimates. Management reviews these estimates periodically and, as adjustments become necessary, they are reported in income in the period in which they become known.

Intangible assets

During 2010, the Company adopted a policy for intangible assets as a result of transactions completed in 2010. The costs incurred to create a management services contract between SAM LP and one of the funds managed by SAM LP are recognized as an intangible asset with an indefinite life and are not amortized but are subject to impairment

review at least annually and, if impaired, written down to fair value.

Future changes in accounting policies

International Financial Reporting Standards (“IFRS”)

The Canadian Accounting Standards Board has confirmed that the use of IFRS will be required commencing 2011 for publicly accountable, profit oriented enterprises. IFRS will replace current Canadian GAAP followed by the Company. The Company will be required to begin reporting under IFRS for its fiscal year ended December 31, 2011 and will be required to provide information that conforms with IFRS for the comparative periods presented. Management implemented an IFRS changeover plan and completed its preliminary analysis of transition impacts in 2009.

For the remainder of 2010, the Company will continue to monitor new standards and amendments to existing IFRS standards and evaluate their impact.

3. PROPRIETARY INVESTMENTS

Proprietary investments consist of the following (\$ in thousands):

	June 30, 2010	December 31, 2009
<u>Precious metal bullion</u>		
Gold bullion	7,389	6,435
<u>Securities designated as held for trading</u>		
Public equities and share purchase warrants	1,688	4,581
Mutual funds and hedge funds	1,042	831
	2,730	5,412
<u>Loans and receivables</u>		
Secured note receivable	14,412	14,338
<u>Securities available for sale</u>		
Public equities	—	93
Private equities	1,151	1,726
	1,151	1,819
<u>Total proprietary investments</u>	25,682	28,004

Fair value disclosures

The table below sets forth information about the level within the fair value hierarchy prescribed by Section 3862 at which the Company’s securities designated as held for trading are measured at June 30, 2010 (\$ in thousands):

	Quoted price in active markets for identical assets (Level 1)	Other significant observable inputs (Level 2)	Total
<u>Securities designated as held for trading</u>			
Public equities	1,033	60	1,093
Common share purchase warrants	—	595	595
Mutual funds	523	—	523
Hedge funds	—	519	519
Subtotal	1,556	1,174	2,730

Level 1 securities generally include securities traded on major exchanges, including the TSX and TSX Venture Exchange as well as investments in redeemable mutual funds. Level 2 securities include common shares traded in over-the-counter markets, warrants valued using observable inputs and investments in hedge funds. As at June 30, 2010, the Company does not have any financial instruments that are measured at fair value and are classified as Level 3; there were no transfers between levels during the quarter.

As at June 30, 2010, investments in public equities consisted primarily of investments in equities and share purchase warrants of companies in the gold and uranium sectors.

Investments in mutual funds and hedge funds consisted entirely of investments in mutual funds and hedge funds managed by SAM LP.

Securities classified as loans and receivables consisted of a secured note receivable from a company in the gold sector paying 10% annual interest and maturing in 2014 and is recorded at amortized cost, less impairment, if any. As at June 30, 2010, the fair value of this secured note receivable approximated its carrying value.

Securities classified as available for sale consisted of an investment in common stock of a private company in the gold and precious minerals sector presented at cost.

4. SHAREHOLDERS' EQUITY

(a) Capital stock and contributed surplus

Capital stock consists of the following:

	Number of shares	Stated value \$ (in thousands)
Authorized		
Unlimited common shares, without par value		
Issued		
Balance, December 31, 2008	150,000,000	40,105
Issuance of common shares on exercise of stock options	—	—
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Balance, December 31, 2009	150,000,000	40,105
Issuance of common shares on exercise of stock options	—	—
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Balance, June 30, 2010	150,000,000	40,105

Contributed surplus relates to stock option expense and consists of the following:

	Stated value \$ (in thousands)
Balance, December 31, 2008	1,524
Expensing of fair value of 2,550,000 Sprott Inc. stock options over the vesting period	2,296
Balance, December 31, 2009	3,820
Expensing of fair value of 2,500,000 Sprott Inc. stock options over the vesting period	1,134
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Balance, June 30, 2010	4,954

(b) Stock option plans

On April 3, 2008, the Company adopted an option plan (the "Plan") to provide incentives to directors, officers, employees and consultants of the Company and its wholly owned subsidiaries. The aggregate number of shares issuable upon the exercise of all options granted under the Plan shall not exceed 10% of the issued and outstanding shares of the Company as at the date of grant of each option under the Plan. The options may be granted at a price that is not less than the market price of the Company's common shares at the time of the grant. The options vest annually over a three-year period and may be exercised during a period not to exceed 10 years from the date of grant.

The details of option grants are as follows:

Date	Number of options	Fair market value	Exercise price	Expiry date	Inputs used to calculate fair value
Date of grant: May 6, 2008	2,450,000	\$2.71	\$10	May 6, 2018	Risk-free rate of 3.05%, expected life of 5 years, weighted average volatility of 28% and expected dividend yield of 1%
Date of grant: June 2, 2008	100,000	\$2.49	\$9.06	June 2, 2018	Risk-free rate of 3.27%, expected life of 5 years, weighted average volatility of 28% and expected dividend yield of 1%
Date of cancellation: January 8, 2010	(100,000)	\$2.49	\$9.06		
Date of grant: January 15, 2010	50,000	\$3.27	\$4.85	January 15, 2020	Risk-free rate of 2.35%, expected life of 5 years, weighted average volatility of 40% and expected dividend yield of 2.06%
As at June 30, 2010	2,500,000				

As at June 30, 2010, 1,633,333 options were exercisable.

For the three and six months ended June 30, 2010, the Company recorded a compensation expense of \$0.6 million (2009 – \$0.6 million) and \$1.1 million (2009 – \$1.1 million), with a corresponding increase to contributed surplus.

(c) Objectives of managing capital

The Company's objectives when managing capital are:

- To meet regulatory requirements and other contractual obligations;
- To safeguard the Company's ability to continue as a going concern so that it can continue to provide returns for shareholders; and
- To provide an adequate return to shareholders through the growth in assets under management and growth in management fees and incentive fees that will result in higher dividend payments to shareholders.

The Company's capital is comprised of equity, including capital stock, contributed surplus and retained earnings. The Company is the sole limited partner of three limited partnerships: SPW LP, SAM LP and SCLP. SPW LP is a member of IIROC and SAM LP is a registrant of the Ontario Securities Commission; as a result, both limited partnerships are required to maintain a minimum level of regulatory capital. To ensure compliance, senior management monitors regulatory and working capital on a regular basis. As at June 30, 2010, the Company's subsidiaries were in compliance with the capital requirements.

In the normal course of business, the Company, through its wholly owned subsidiaries, generates adequate operating cash flow and has limited capital requirements.

The Company may adjust its capital levels in light of changes in business-specific circumstances as well as overall economic conditions.

5. RELATED PARTY TRANSACTIONS

(a) Cadomin Capital Corporation (formerly Sprott Molybdenum Participation Corporation (“Sprott Moly”))

Prior to July 2009, Sprott Moly was a related party of the Company because SAM LP provided investment management services to it and the Company owned 3,976,000 or 10.08% of its issued and outstanding common shares. In July 2009, Sprott Moly underwent a corporate reorganization as a result of which it ceased to be a related party of the Company and was renamed Cadomin Capital Corporation. As a result of this reorganization, the Company exchanged 3,976,000 shares or 10.08% of Sprott Moly for 3,976,000 shares of Cadomin Capital Corporation (now an unrelated company) at approximately \$1.76 per share in cash. The investment management contract between SAM LP and Sprott Moly was terminated immediately before the reorganization.

(b) Artwork rental

Historically, the Company rented artwork from Mr. Sprott, Chief Executive Officer of the Company, as well as from Sprott Securities Ltd., a corporation wholly owned by Mr. Sprott. The rental rate was equal to 3% per annum of the amount paid to acquire the artwork displayed in the office area of the Company.

Commencing in May 2009, Mr. Sprott terminated the artwork rental contract with himself as well as Sprott Securities Ltd. As a result, there were no artwork rental fees incurred in the three and six months ended June 30, 2010. In 2009 SAMI incurred an expense of \$0.07 million and \$0.3 million respectively.

(c) Purchase of proprietary investments from Sprott Strategic Gold Master Fund Ltd.

In January 2009, the Company purchased certain portfolio investments from Sprott Strategic Gold Master Fund Ltd., pursuant to the compulsory redemption of all the holders of that fund. Some of those investments were investments in private companies for which there was no active market. Those investments were purchased for \$1.8 million, were classified as “available for sale” and recorded at cost less any permanent impairment. Some of those investments have subsequently started trading in a public market and were disposed of by the Company. As a result, as at June 30, 2010 the Company only holds one such investment.

6. FIXED ASSETS

Fixed assets consist of the following (\$ in thousands):

	June 30, 2010		
	Cost \$	Accumulated amortization \$	Net book value \$
Artwork	1,691	—	1,691
Furniture and equipment	1,751	1,211	540
Computer hardware and software	1,061	1,020	41
Leasehold improvements	3,097	1,365	1,732
	7,600	3,596	4,004

	December 31, 2009		
	Cost \$	Accumulated amortization \$	Net book value \$
Artwork	1,691	—	1,691
Furniture and equipment	1,739	1,077	662
Computer hardware and software	1,039	1,016	23
Leasehold improvements	3,068	1,146	1,922
	7,537	3,239	4,298

7. COMMITMENTS

(a) Lease commitments

Future minimum annual rental payments under a non-cancellable lease which expires on December 31, 2013 for office premises, including operating costs, are as follows:

	\$ (in thousands)
2010	792
2011	1,584
2012	1,584
2013	1,584
	5,544

In July, 2010, the Company amended its existing lease agreement to increase the total area leased thereunder, which resulted in additional commitments for office premises, including operating costs amounting to \$136 thousand in 2010 and \$815 thousand in each of 2011, 2012 and 2013.

(b) Other

On June 9, 2010, SCLP and Quest Capital Corp. ("Quest"), an issuer unrelated to the Company, signed a letter of intent pursuant to which the parties confirmed their mutual understanding and intention to work together concerning the restructuring of the business of Quest, the change in Quest's lending strategy from real estate to natural resource lending, the rebranding and change of name of Quest, an investment in Quest by the Company (together with its affiliates and certain related persons) by way of a private placement, the entering into a management services agreement and certain related matters in respect of Quest and its governance and management (collectively, the "Quest Reorganization").

Within a period of seven days after August 30, 2010, unless extended, the Company along with certain of its employees and clients will make an investment in Quest through a private placement of up to \$25 million.

The Quest Reorganization remains subject to certain shareholder and regulatory approvals.

8. EARNINGS PER SHARE

For the three and six months ended June 30, 2010, basic and diluted earnings per common share were \$0.05 and \$0.09, respectively. For the three and six months ended June 30, 2009, basic and diluted earnings per common share were \$0.04 and \$0.09, respectively. Earnings per share is calculated using the weighted average number of shares outstanding during the relevant periods. For both the three and six months ended June 30, 2010 and June 30, 2009, the weighted average number of shares was 150,000,000.

9. INCOME TAXES

The reconciliation of the Company's effective tax rate to the statutory tax rate is as follows:

	Three months ended June 30, 2010 \$ (in thousands)	Six months ended June 30, 2010 \$ (in thousands)
Income taxes at statutory tax rate (31.25%)	3,367	6,081
Decrease in income taxes resulting from:		
Non-taxable portion of capital gains and other	(267)	(222)
Income tax provision as reported (effective tax rate of 28.77% and 30.11%, respectively)	3,100	5,859
	Three months ended June 30, 2009 \$ (in thousands)	Six months ended June 30, 2009 \$ (in thousands)
Income taxes at statutory tax rate (33%)	2,587	6,160
Decrease in income taxes resulting from:		
Rate differences and other	(339)	(505)
Income tax provision as reported (effective tax rate of 28.68% and 30.30%, respectively)	2,248	5,655

As at June 30, 2010, the future tax asset in the amount of \$1.0 million related entirely to foreign accrual property losses and capital losses. The future tax liability of approximately \$1.0 million relates to future taxes associated with unrealized gains as well as certain items which are deductible for income tax purposes, but capitalized for accounting purposes. As at June 30, 2010, the Company had approximately \$6.7 million of unused capital losses.

10. OTHER LONG-TERM ASSETS

As at June 30, 2010, other long-term assets consist of an intangible asset with an indefinite useful life, which is tested for impairment at each reporting period. The intangible asset relates to certain costs incurred to create a management services contact between SAM LP and one of the funds managed by SAM LP.

11. VARIABLE INTEREST ENTITIES (“VIEs”)

Certain hedge funds and offshore funds are structured as limited partnerships in which the Company, through its subsidiary entities, holds general partner interests in the partnerships, which entitle the Company to participate in a portion of the carried interest of the partnerships. Some of the offshore funds managed by the Company structured as corporations and public mutual funds managed by the Company have shareholders or unitholders whose ownership, although substantial, lacks the characteristics of a controlling financial interest. The Company has a direct investment in several such offshore funds, and in certain public mutual funds. Management has concluded that the Company is not the primary beneficiary of these funds and, thus, is not required to consolidate these entities. The Company has no other significant interests in VIEs. The Company’s maximum exposure to loss as a result of its involvement with VIEs is a function of the amounts invested in the funds, management fees and performance fees.

12. RISK MANAGEMENT ACTIVITIES

Financial instruments present a number of specific risks as identified below:

(a) Market risk

Market risk refers to the risk that a change in the level of one or more of market prices, interest rates, foreign exchange rates, indices, volatilities, correlations or other market factors, such as liquidity, will result in a decrease in the fair value of a financial instrument. The Company’s financial instruments are classified as held for trading, available for sale or loans and receivables and measured either at fair value or cost less permanent impairment, if any. Therefore, changes in fair value or permanent impairment, if any, affect reported earnings as they occur. The maximum risk resulting from financial instruments is determined by the fair value of the financial instruments classified as held for trading and cost less permanent impairment, if any, for investments classified as available for sale or loans and receivables. The Company manages market risk by regular monitoring of its proprietary investments.

The Company separates market risk into three categories: price risk, interest rate risk and foreign exchange risk.

Price risk

Price risk arises from the possibility that changes in the price of the Company’s proprietary investments will result in changes in carrying value. For a listing of the Company’s proprietary investments, refer to Note 3.

If the market values of proprietary investments that are held for trading increased by 5%, with all other variables held constant and before tax, this would have increased income before income taxes by approximately \$0.1 million (December 31, 2009 - \$0.3 million); conversely, if the value of proprietary investments decreased by 5%, this would have decreased income by the same amount.

If the market value of gold bullion increased by 5%, with all other variables held constant and before tax, this would have increased income before income taxes by approximately \$0.4 million (December 31, 2009 - \$0.3 million); conversely, if the value of gold bullion decreased by 5%, this would have decreased income by the same amount.

The Company’s revenues are also exposed to price risk since both management fees and performance fees are correlated with assets under management, which fluctuates with changes in the market values of the assets in the funds and managed accounts managed by SAM LP and SCLP. Assets under management refer to the total assets of Sprott funds and managed accounts, less total liabilities, on which management fees and performance fees are calculated.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial

instruments. The Company does not hedge its exposure to interest rate risk as such risk is minimal. As part of its cash management program, the Company primarily invests in short-term debt securities issued by the Government of Canada with maturities of less than three months.

In the second quarter of 2009, the Company, through its wholly owned subsidiary, SAMGENPAR Ltd., invested approximately \$14 million in a secured note bearing an interest rate of 10% per annum and secured against the assets of the issuer. There is no interest rate risk that could immediately affect earnings associated with this investment as it is carried at amortized cost and management intends to hold the investment to maturity.

Foreign exchange risk

Foreign exchange risk arises from the possibility that changes in the price of foreign currencies will result in changes in carrying value. The Company holds assets denominated in currencies other than the Canadian dollar. It is therefore exposed to currency risk, as the value of investments denominated in other currencies will fluctuate due to changes in exchange rates. The Company does not enter into currency hedging transactions.

As at June 30, 2010, approximately \$7.9 million or 7.79% (December 31, 2009 - \$8.0 million or 8.2%) of total assets was invested in proprietary investments held for trading and precious metal bullion priced in U.S. dollars ("USD"). Furthermore, a total of \$0.9 million (December 31, 2009 - \$0.5 million) of cash, \$0.8 million of accounts receivable (December 31, 2009 - \$7.6 million) and \$0.1 million (December 31, 2009 - \$0.2 million) of other assets were denominated in USD. As at June 30, 2010, had the exchange rate between the USD and the Canadian dollar increased or decreased by 5%, with all other variables held constant and before tax, the increase or decrease, respectively, in income before income taxes would have amounted to approximately \$0.5 million (December 31, 2009 - \$0.8 million).

(b) Credit risk

Credit risk arises from the potential that counterparties will fail to satisfy their obligations as they come due. The Company incurs credit risk when entering into, settling and financing various proprietary transactions. As at June 30, 2010, the Company's most significant counterparty is Cormark, the carrying broker of SPW LP, which also acts as a custodian for most of the Company's proprietary investments. Cormark is registered as an investment dealer subject to regulation by the IIROC; as a result, it is required to maintain minimal levels of regulatory capital at all times.

The Company's main exposure to credit risk relates to the secured note receivable, as disclosed in Note 3. The credit risk is managed by the terms of the agreement, in particular, the note is secured and the issuer is subject to a number of financial covenants, which are monitored on a regular basis.

Credit risk is also managed by dealing with counterparties that the Company believes to be creditworthy and by actively monitoring credit exposure and the financial health of the counterparties. The majority of accounts receivable relate to management and performance fees receivable from the funds and managed accounts managed by the Company.

(c) Liquidity risk

Liquidity risk is the risk that the Company cannot meet a demand for cash or fund its obligations as they come due. The Company's exposure to liquidity risk is minimal as it maintains sufficient levels of liquid assets to meet its obligations as they come due. As at June 30, 2010, the Company had \$65.0 million or 64.2% of its total assets in cash and cash equivalents. The majority of current assets reflected on the consolidated balance sheets are highly liquid. Approximately \$8.4 million or 32.8% of proprietary investments held by the Company are readily marketable and are recorded at their fair value. Financial liabilities, including accounts payable and accrued liabilities and compensation and employee bonuses payable, are short-term in nature and are generally due within a year. The Company's management is responsible for reviewing liquidity resources to ensure funds are readily available to meet its financial obligations as they come due, as well as ensuring adequate funds exist to support business strategies and operations growth. The Company manages liquidity risk by monitoring cash balances on a daily basis.

13. SEGMENTED INFORMATION

Management has determined that the Company's dominant industry segment is investment management services in Canada. Substantially all of the Company's assets are located in Canada.

14. CONTINGENT LIABILITIES AND INDEMNITIES

In the normal course of operations, former employees may from time to time file claims for additional compensation. The Company is currently defending itself against such claims. The amount of losses, if any, are not determinable at this time.

In the first quarter of 2010, the Company provided an indemnification to certain offshore funds managed by SAM LP. The maximum exposure under the indemnification is approximately \$10 million. The Company is of the view that the likelihood of loss in relation to such indemnities is very remote and, as such, no amount has been accrued in the Company's consolidated financial statements.

15. SUBSEQUENT EVENTS

(a) Dividend

In August 2010, a dividend of \$0.025 per common share was declared for the quarter ended June 30, 2010.

(b) Related Party Transaction

In July, 2010, Sprott Inc. announced that, Mr. Peter Grosskopf will be appointed by the Company as its new CEO in September 2010. In recognition of Mr. Grosskopf's past accomplishments in the financial services industry and to acknowledge the future contributions of Mr. Grosskopf and Mr. Bambrough, the Company's President, Eric Sprott has personally agreed to fund a deferred share incentive program through his personal holding company ("Holdco"). The program will provide Mr. Grosskopf with five million common shares of Sprott Inc. held by Holdco over a specified period, and Mr. Bambrough with three million common shares of Sprott Inc. also over a specified period. With this transfer of eight million common shares of Sprott Inc., Holdco's ownership stake will be reduced by approximately 8%. This arrangement does not contemplate any issuance of shares from treasury by the Company.

(c) Lease Commitments

In July, 2010, the Company amended its existing lease agreement to increase the total area leased thereunder; refer to Note 7 for further details.