

Form 51-102F1
Interim Management Discussion and Analysis
For
Stornoway Diamond Corporation
(“Stornoway” or the “Corporation”)
For the three months ended July 31, 2014, containing information up to
and including September 9, 2014

The following interim management discussion and analysis (“MD&A”) of the Corporation’s financial condition and results of operations for the three months ended July 31, 2014 should be read in conjunction with the unaudited condensed interim consolidated financial statements for the three months ended July 31, 2014 and the audited consolidated financial statements and annual MD&A for the years ended April 30, 2014 and 2013 together with the notes thereto. These financial statements have been prepared in Canadian dollars, which is the Corporation’s presentation and functional currency, in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”). The Corporation’s significant accounting policies are set out in Note 2 of the annual audited consolidated financial statements for the years ended April 30, 2014 and April 30, 2013 and in Note 2 of the unaudited condensed interim consolidated financial statements for the three months ending July 31, 2014. Additional information on the Corporation, including the Corporation’s Annual Information Form (“AIF”) dated July 24, 2014 and other continuous disclosure documents can be accessed through the System for Electronic Document Analysis and Retrieval (“SEDAR”) website at www.sedar.com and from the Corporation’s website at www.stornowaydiamonds.com. To the extent applicable, updated information contained in this MD&A supersedes older information contained in previously filed continuous disclosure documents. Information contained on the Corporation’s website is not incorporated by reference herein and does not form part of this MD&A. This MD&A contains forward looking statements that are based on certain estimates and assumptions and involve risks and uncertainties. Actual results may vary materially from management’s expectations. See the “Forward Looking Statements” section later in this MD&A for further information.

Technical disclosure for the Renard Diamond Project included in this MD&A, with the exception of the technical disclosure related to mineral resources, has been reviewed by Patrick Godin, Ing. (Québec). Mr. Godin is Stornoway’s Chief Operating Officer (“COO”) and a Qualified Person (“QP”) under National Instrument 43-101 – Standards of Disclosure for Mineral Projects (“NI 43-101”). Technical disclosure related to the Renard Diamond Project’s mineral resources has been reviewed by Robin Hopkins, P.Geol. (NT/NU), Stornoway’s Vice-President, Exploration and a QP under NI 43-101.

The Board of Directors approved this MD&A on September 9, 2014.

OVERVIEW

Stornoway is a Canadian diamond exploration and development company listed on the TSX and headquartered in Longueuil, Québec. Stornoway's principal focus is its 100% owned Renard Diamond Project located in north-central Québec, a project in construction with the potential to become Québec's first diamond mine. Stornoway's strategy is to build a growth-oriented company that succeeds in the business of mining and selling rough diamonds. Stornoway's long term view of the rough diamond market is positive, based on its outlook for a tightening mine supply and growing demand, particularly in developing markets, resulting in real, long term price growth. In this context, Stornoway is well positioned, with the completion of a series of financing transactions on July 8, 2014, to build the Renard Diamond Project as Québec's first diamond mine. The Corporation has a management team with experience at each stage of the diamond pipeline, from exploration through development, mine construction, operations and marketing.

On July 8, 2014 the Corporation completed a series of financing transactions for gross proceeds of \$946¹ million, including the issuance of convertible debentures, a public offering of securities and private placements of subscription receipts with Orion Co-Investments I Limited ("Orion"), Ressources Québec ("RQ") and Diaquem Inc. ("Diaquem") both wholly-owned subsidiaries of Investissement Québec ("IQ"), and the Caisse de dépôt et placement du Québec ("CDPQ"). Gross proceeds received on July 8, 2014 totaled \$458 million². In addition, the Corporation entered into several financing agreements concurrently for a diamond streaming agreement (the "Stream"), a senior secured loan, an equipment finance facility and cost over-run facilities (collectively with the convertible debentures, public offering and private placements, the "Financing Transactions"). Proceeds of US\$250 million from the Stream are expected to be received in three tranches, beginning in March 2015; the Corporation expects to draw from the \$100 million Senior Secured Loan, Tranche A during 2016 and the Corporation expects to borrow up to US\$35 million under Tranche A of its equipment finance facility beginning in 2014. Subject to meeting certain conditions precedent, the Corporation should also be able to borrow up to \$48 million from the cost over-run facilities arranged as part of the Financing Transactions. So long as the Corporation meets the conditions precedent to the Stream, Senior Secured Loan and cost over-run facilities (if needed), the Corporation anticipates that proceeds from the Financing Transactions will be sufficient to meet its capital requirements over about a 36-month period, to the commencement of commercial production at the Renard Diamond Project. Proceeds from the Financing Transactions will be used for construction of a mine at the Renard Diamond Project, as well as interest and financing expenses during the construction period and for working capital (see "*Completed Financings – Three months ended July 31, 2014*" below). Following the conclusion of the Financing Transactions, the Corporation's Board of Directors made a formal decision to proceed to mine construction and production at Renard. Construction activities started immediately and the Corporation expects to commence commercial production of rough diamonds in the second quarter of 2017. The Financing Transactions are intended to provide a comprehensive funding package for the development of the Renard Diamond Project, which has an estimated capital cost of \$811 million, including contingencies and escalation.

¹ For illustrative purposes, assumes a C\$:US\$ conversion rate of \$1.10. Actual proceeds of each financing tranche are measured at the C\$:US\$ exchange rate in effect on the date the funds are received.

² As at July 8, 2014 C\$:US\$ conversion rate of \$1.0674

Additional Key Highlights for the three months ended July 31, 2014:

- Approval of resolutions related to the Financing Transactions by the Corporation's shareholders at a Special General Meeting held on June 26, 2014;
- Receipt of gross proceeds of \$254 million and US\$110 million released from escrow (from the subscription receipts issued on May 23, 2014 in connection with the Corporation's public and private common share offerings) and gross proceeds of US\$81.3 million from the issuance of convertible debentures on July 8, 2014. The Corporation's net proceeds totalled \$431 million at closing, after deducting a 4% discount on the convertible debentures and expenses paid at closing;
- The appointment of Mr. Douglas Silver to the Corporation's Board of Directors as the nominee of Orion Mine Finance, a significant investor in the Financing Transactions;
- Initiated project construction with a focus on site civil works, equipment procurement and camp construction. No major variances forecast to date against the planned budget or schedule;
- The execution of an engineering, procurement and construction management ("EPCM") contract with SNC-Lavalin Inc. ("SNC") with certain sub-contracted services to be provided by AMEC Americas Ltd. ("AMEC") and DRA Americas Inc. ("DRA") for certain specialized engineering and field support services relating to the project's diamond processing plant and diamond recovery circuits; and
- Continuation of the resource expansion drill program which commenced in April 2014, with Renard 2 now confirmed to a vertical depth of 970 meters in an ongoing resource expansion drill program, 370 meters below the base of the current Mineral Reserve.

RESULTS OF OPERATIONS AND FINANCIAL ACTIVITIES

Quarterly Statement of Loss

	Three Months Ended		
<i>(expressed in thousands of Canadian dollars)</i>	July 31, 2014	July 31, 2013	Increase (decrease)
Exploration recovery	(548)	(66)	(482)
Office, rent and sundry	425	555	(130)
Professional fees, regulatory and shareholder communication	313	410	(97)
Salaries, benefits and directors' fees	1,287	581	706
Share-based payments	1,689	19	1,670
Operating Expenses	(3,166)	(1,499)	1,667
Other income (expenses)			
Transaction fees – derivatives	(2,125)	-	2,125
Loss on fair value of derivatives	(3,387)	-	3,387
Foreign exchange gain	2,289	-	(2,289)
Finance costs	(4,875)	81	4,956
	(8,098)	81	8,179
Loss before Income Taxes	(11,264)	(1,418)	9,846
Deferred income tax expense	(251)	-	251
Loss for the Period	(11,515)	(1,418)	10,097

The Corporation's basic and diluted loss per share for the three months ended July 31, 2014 (the "Current Period") was \$0.04 as compared to a basic and diluted loss per share of \$0.01 for the three months ended July 31, 2013 (the "Comparative Period").

The significant increase in the Current Period loss is attributable primarily to other income and expenses of \$8.1 million (Comparative Period - \$0.1 million) which relate to the Corporation's financing activities and in particular, to transaction fees and changes in the fair value of derivatives during the quarter. Finance costs include \$0.3 million for standby fees on the Corporation's various financing facilities and \$4.5 million for transaction costs directly related to the liability portion of private placement subscription receipts which were received in US dollars (see Note 9a of the condensed, interim consolidated financial statements for the three months ended July 31, 2014). The transaction costs are a one-time expense during the Current Period since the subscription receipts were converted into common shares as at July 8, 2014. In addition, the Corporation recorded a foreign exchange gain of \$2.3 million (Comparative Period - \$nil) related to the convertible debentures and US dollar cash. Other income and expenses of \$8.1 million for the Current Period comprise 70% of the Corporation's first quarter loss of \$11.5 million.

Salaries, benefits and director's fees (Current Period - \$1.3 million; Comparative Period - \$0.6 million) and share-based payment expense (Current Period - \$1.7 million; Comparative Period - \$0.02 million) were the largest general and administrative expenses in the Current Period, comprising 94% of operating expenses of \$3.2 million. During the Current Period and in connection with the closing of the Financing Transactions, the Corporation paid bonuses its employees, including special bonuses for the CEO, CFO and COO which were linked to the successful financing of the Renard Diamond Project. In addition, during July 2014 the Corporation granted 17,695,000 stock options to directors, officers and employees (approximately 2.4% of the post-financing issued and outstanding share capital) and recorded share-based payment expense of \$1.7 million for the stock options which vested in the Current Period. In the Comparative Period, the Corporation granted 100,000 stock option to an employee and recorded share-based payment expense of \$0.02 million. The Corporation's other general and administrative expenses totaled \$0.2 million in the Current Period, including an exploration recovery of \$0.6 million (Comparative Period - \$0.1 million exploration recovery). Deferred income tax expense totaled \$0.3 million as compared to \$nil in the Comparative Period.

Statements of Cash Flows

<i>(expressed in thousands of Canadian dollars)</i>	<u>Three months ended</u>	
	July 31, 2014	July 31, 2013
Cash used in operating activities, before changes in non-cash working capital	(1,785)	(1,182)
Changes in non-cash working capital	347	(6,520)
Cash used in operating activities	(1,438)	(7,702)
Cash used in investing activities	(25,761)	(12,645)
Cash provided by financing activities	436,934	11,991
Effect of foreign exchange rate changes on cash and cash equivalents	1,536	-
Increase (decrease) in cash and cash equivalents	411,271	(8,356)
Cash and cash equivalents - Beginning of the Period	26,983	32,882
Cash and cash equivalents – End of the Period	438,254	24,526

During the three months ended July 31, 2014, the Corporation's cash and cash equivalents increased by \$409.7 million, before a \$1.5 million foreign exchange rate change on cash and cash equivalents maintained in US dollars associated with the US dollar portion of the financings.

During the Current Period, the Corporation received net proceeds of \$83.3 million from the issuance of US\$81.3 million convertible debentures (Comparative Period - \$nil) after a 4% discount on the principal amount (US\$3.3 million) received from the purchasers and before debenture issuance costs of \$4.4 million. The Corporation received \$373.9 million from the issuance of subscription receipts by way of a public offering and private placements (see "*Completed Financings – Three Months Ended July 31, 2014*" below), before share issuance costs of \$17.4 million. In addition, the Corporation paid a subordination fee of \$0.6 million related to long-term debt. In the Comparative Period, the Corporation received \$0.03 million from the exercise of stock options (Current Period - \$nil) and expended \$1.2 million on financing fees (Current Period - \$4.9 million). The Corporation also received proceeds of \$7.1 million from the issuance of long-term debt (Comparative Period - \$13.8 million). Net proceeds from financing activities totaled \$436.9 million in the Current Period as compared to \$12.0 million in the Comparative Period. See "*Completed Financings – Three months ended July 31, 2014*" below for additional information.

Investing activities totaled \$25.8 million in the Current Period, of which \$24.3 million was used for the acquisition of property, plant and equipment (Comparative Period - \$9.1 million) and \$2.1 million related to an increase in other assets (Comparative Period - \$nil). Fuel inventory decreased by \$0.7 million in the Current Period (Comparative Period - \$3.5 million increase). In the Current Period, the Corporation continued to build the Renard Mine Road and Renard Airstrip with loan proceeds of \$7.1 million and commenced mine construction activities on July 10, 2014 at the Renard Diamond Project (see "*Construction Highlights*" under "*Material Mineral Project – Renard Diamond Project, Québec*" below).

Changes in non-cash working capital include a net increase in receivables of \$3.9 million (Comparative Period - \$2.6 million) as well as increases in prepaid expenses and deposits (\$1.2 million). Payables and accrued liabilities increased by \$5.4 million in the Current Period, as compared to a decrease of \$4.1 million in the Comparative Period resulting from an increase in the Corporation's financing and investing activities as compared to the same period in 2013. The Corporation used \$1.4 million for operating activities in the Current Period (Comparative Period - \$7.7 million).

Statements of Financial Position

<i>(expressed in thousands of Canadian dollars)</i>	Three Months Ended July 31, 2014	Year Ended April 30, 2014	Increase / (decrease)
Cash and cash equivalents	438,254	26,983	411,271
Other current assets	6,803	2,514	4,289
Deferred financing fees	17,684	8,069	9,615
Rough diamond inventory	1,004	1,004	-
Property, plant and equipment	298,525	260,728	37,797
Other assets	5,090	-	5,090
Total assets	767,360	299,298	468,062
Current liabilities	19,265	30,450	(11,185)
Long-term debt	95,293	57,203	38,090
Convertible debentures	86,935	-	86,935

Deferred income tax liabilities	793	-	793
Asset retirement obligation	1,995	1,981	14
Equity	563,079	209,664	353,415
Total liabilities and equity	767,360	299,298	468,062

During the Current Period, total assets increased by \$468.1 million to \$767.4 million due primarily to cash and cash equivalents received pursuant to the Financing Transactions (see “*Completed Financings – Three months ended July 31, 2014*” below) and additions to property, plant and equipment. The Corporation’s property plant and equipment increased by \$37.8 million due to the commencement of mine construction at the Renard Diamond Project and ongoing construction activities to build the Renard Mine Road. The balance of the increase relates to \$9.6 million in deferred financing fees, reflecting the costs associated with arranging financing for the Renard Diamond Project and an increase of \$4.3 million in other current assets and \$5.1 million in other assets.

The Corporation’s current liabilities of \$19.3 million consist primarily of payables and accrued liabilities. As at April 30, 2014, the current debt of \$19.9 million related to an unsecured, non-revolving bridge facility from Diaquem which was to mature on June 27, 2014. The maturity date of this facility was extended on June 26, 2014 until the earlier of: closing of Tranche A of the Senior Secured Loan (anticipated to take place in 2016) and June 30, 2017 (see “*Completed Financings – Three months ended July 31, 2014*” below for additional details). Accordingly, amounts due under this facility from Diaquem are included as long-term debt as at July 31, 2014. Long-term debt increased by \$38.1 million during the three months ended July 31, 2014, as the Corporation borrowed additional amounts to finance the Renard Mine Road construction and extended the maturity date of the Diaquem bridge facility past twelve months. In addition, the Corporation issued US\$81.3 million (before a discount of 4% to the purchaser) of Convertible debentures on July 8, 2014.

As at July 31, 2014, equity consists of share capital, contributed surplus, accumulated other comprehensive loss and a deficit of \$241.7 million (April 30, 2013 - \$230.2 million). Share capital increased from \$362.9 million to \$765.2 million from the conversion of subscription receipts for common shares (private placements) and the conversion of subscription receipts for common shares and warrants (public offering). During the three months ended July 31, 2014, the Corporation issued 626,863 common shares for an interest payment and converted 22,543,918 non-voting convertible shares into common shares in connection with IQ’s participation in the Financing Transactions. As at July 31, 2014, the Corporation had 730,949,299 common shares issued and outstanding and no non-voting convertible shares outstanding. On June 20, 2014, in connection with the Financing Transactions, all 22,543,918 non-voting convertible shares of the Corporation were converted into common shares of the Corporation for no further compensation, and the Corporation’s Articles were amended to eliminate this share class.

SELECTED QUARTERLY INFORMATION

The following table sets out selected unaudited consolidated quarterly financial information of Stornoway covering the last eight quarters and is derived from the unaudited condensed interim consolidated financial statements prepared by management in accordance with International Accounting Standards 34, Interim Financial Reporting (“IAS 34”), using the same accounting policies and methods of application as the audited consolidated financial statements of the Corporation.

Quarter Ended	Net Loss (in thousands of Canadian dollars)	Basic and Diluted Loss per share
July 31, 2014	11,515	0.04
April 30, 2014	7,886	0.07
January 31, 2014	1,347	0.01
October 31, 2013	1,648	0.01
July 31, 2013	1,418	0.01
April 30, 2013	12,085	0.07
January 31, 2013	5,187	0.03
October 31, 2012	12,123	0.08

Quarterly results will vary in accordance with the Corporation's exploration, development, construction and financing activities. Historically, exploration and evaluation expenses, share-based payment expenses and, to a lesser extent exploration and evaluation asset write-offs had the most significant impact on the Corporation's quarterly results, followed by general and administrative expenses (which include exploration and evaluation expenses). Starting July 10, 2014, the Corporation will be in a period of construction until the second quarter of 2017 (approximately) when the commencement of commercial production is expected to occur at the Renard Diamond Project. It is likely that the Corporation's quarterly results will continue to fluctuate until the Corporation reaches the operations phase, expected to occur by mid-2017. In connection with the Financing Transactions, the Corporation received proceeds in US dollars and issued US dollar denominated convertible debentures which have an embedded derivative which will be revalued at each balance sheet date. Changes in the fair value of the derivative are recorded in the consolidated statements of loss and can reasonably be expected to affect the Corporation's future quarterly results (see Note 3 "*Critical Accounting Estimates and Judgments*" in the condensed interim consolidated financial statements for the three months ended July 31, 2014). Fluctuations in the Canadian dollar, which is the Corporation's functional currency, against the US dollar will also affect the Corporation's quarterly results in the future for cash and cash equivalents and liabilities denominated in US dollars.

LIQUIDITY AND CAPITAL RESOURCES

As at July 31, 2014 the Corporation had current assets of \$445.1 million to settle current liabilities of \$19.3 million, resulting in working capital of \$425.8 million. Included in current assets as at July 31, 2014 is \$7.1 million which must be used for the development of the Renard Mine Road and \$5.1 million from a flow-through financing which closed in December 2013. Funds from the flow-through financing must be used to incur qualifying exploration expenses before December 31, 2014.

The estimated capital cost for mine construction at the Renard Diamond Project is \$811 million, including contingencies and escalation. In addition, financing costs and general working capital needs will increase the Corporation's cash requirements during the construction period until positive cash-flow from operations commences. The construction period started in July 2014 and is expected to last 27 months, followed by a further 6 to 9 months for process plant commissioning.

On July 8, 2014, the Corporation received gross proceeds of \$458 million³, consisting of \$254 million and US\$110 million released from escrow (from the subscription receipts issued on May 23, 2014 in

³ As at July 8, 2014 C\$:US\$ conversion rate of \$1.0674

connection with the Corporation's public and private common share offerings) and gross proceeds of US\$81.3 million from the issuance of convertible debentures before a discount to the purchaser of 4% (US\$3.3 million) of the principal amount. After deducting the 4% discount and other expenses of \$24 million paid on the closing date, the Corporation's net proceeds totaled \$431 million, before the allocation of deferred financing fees to the tranches of financing received on July 8, 2014. Proceeds of US\$250 million from the Stream are expected to be received in three tranches, beginning in March 2015; the Corporation expects to draw from the \$100 million Senior Secured Loan, Tranche A during 2016 and the Corporation expects to borrow up to US\$35 million under Tranche A of the equipment finance facility beginning in 2014. Subject to meeting certain conditions precedent, the Corporation should also be able to borrow up to \$48 million from the cost over-run facilities arranged as part of the Financing Transactions. So long as the Corporation meets the conditions precedent to the Stream, Senior Secured Loan and cost over-run facilities (if needed), the Corporation anticipates that proceeds from the Financing Transactions will be sufficient to meet its capital requirements over about a 36-month period, to the commencement of commercial production at the Renard Diamond Project. Should the Corporation not be able to draw from those facilities, or in the event that the cost over-run facilities are insufficient to complete construction and commissioning of the mine, the Corporation may require additional third party financing or seek to complete further offerings of equity and/or debt securities.

As at July 31, 2014, the Corporation had long-term debt of \$95.3 million (April 30, 2014 - \$57.2 million) and convertible debentures of \$86.9 million (April 30, 2014 - \$nil). A summary of the annual principal and interest payments payable pursuant to the Corporation's indebtedness can be found in Note 4 *"Financial Instruments and Risk Management – Fair Value"* of the condensed interim consolidated financial statements for the three months ended July 31, 2014 and under *"Commitments"* below. As at July 31, 2014, the Corporation was in compliance with all of the covenants contained within the various financing agreements.

The Corporation has no history of profitable operations and its present business is at the development stage. The Corporation has no source of operating cash flow and no assurance that additional funding will be available to it for further exploration and development of its projects when required. As such, the Corporation is subject to many risks common to such enterprises, including under-capitalization, cash shortages and limitations with respect to personnel, financial and other resources and the lack of revenues (see *"Risks and Uncertainties"* in the Corporation's AIF, dated July 24, 2014, for more details). With the recent closing of the Financing Transactions on July 8, 2014, Management believes that the Corporation has sufficient financial resources to meet its planned expenditures for the next 12 to 18 months. Furthermore, the Corporation has sufficient financial resources available to it, subject to certain conditions, to complete the development of a diamond mine at the Renard Diamond Project, and also to provide for general working capital and interest and financing fees during the construction phase, which is expected to last about 36 months (from July 2014 to mid-2017). Failure to obtain additional financing (if required) or failure to meet the loan covenants or conditions precedent in any of the Corporation's outstanding debt facilities or the Stream which prevents the Corporation from drawing from these facilities could result in the delay or indefinite postponement the development of a mine and related infrastructure at the Renard Diamond Project and ultimately the loss of the Corporation's exploration properties, including the Renard Diamond Project.

Completed Financings – Three months ended July 31, 2014

On July 8, 2014, the Corporation completed the Financing Transactions for gross proceeds of \$946⁴ million, which are intended to provide a comprehensive project financing package for the construction of the Renard Diamond Project through to the commencement of commercial production in 2017. The Financing Transactions consist of a combination of senior and subordinated debt facilities, common share equity issuances, warrants, an equipment financing facility and a diamond stream. On July 8, 2014, the Corporation received gross proceeds of \$254 million and US\$110 million from the public and private offerings of common share subscription receipts which were released from escrow and US\$81.3 million from the issuance of convertible debentures. The proceeds of the senior secured loan, the purchase and sale agreement for the diamond stream, the equipment financing facility and the cost over-run facilities (if and when needed) are expected to be made available to the Corporation in due course in accordance with their terms.

i) Private Placements

On May 23, 2014, the Corporation completed private placements of an aggregate of 345,539,916 subscription receipts at \$0.70 (the "Private Placement Subscription Receipts") per Private Placement Subscription Receipt, as follows: (1) 171,254,203 Private Placement Subscription Receipts to Orion Co-Investment I Limited ("Orion") for gross proceeds of US\$110 million; (2) 142,857,142 Private Placement Subscription Receipts to Ressources Québec ("RQ") for gross proceeds of \$100 million; and (3) 31,428,571 Private Placement Subscription Receipts to Caisse de dépôt et placement du Québec ("CDPQ") for gross proceeds of \$22 million. The number of Private Placement Subscription Receipts issued to Orion, whose commitment was in United States dollars, was determined based on the Bank of Canada CAD/USD noon exchange rate on the business day prior to the date that the prospectus offering closed. Each Private Placement Subscription Receipt entitled the holder to receive one Common Share (subject to customary adjustments in certain circumstances). On July 8, 2014, the Private Placement Subscription Receipts were converted into 345,539,916 common shares of the Corporation. In connection with these subscriptions, the Corporation issued a further 20,732,394 common shares (the "Private Placement Fee Shares") on a pro rata basis to Orion, RQ and CDPQ.

The proceeds were placed into escrow, pending satisfaction of certain terms and conditions of the Financing Transactions which ultimately closed on July 8, 2014. Had the Financing Transactions not closed, the proceeds would have been refunded to Orion, RQ and CDPQ and the subscription receipts would have been cancelled. As a result of this conditionality, the Orion subscription receipts are considered to be a financial liability with an embedded derivative upon initial recognition because the Corporation must deliver a fixed number of common shares upon conversion of the subscription receipts but the value received by the Corporation is variable, because the Corporation's functional currency is in Canadian dollars and the proceeds are in US dollars.

The fair value of the derivative was determined by taking the difference between the Corporation's share price on May 23, 2014 (\$0.71 converted into US\$0.65150, using an exchange rate of 1.0898)

⁴ For illustrative purposes, assumes a C\$:US\$ conversion rate of \$1.10. Actual proceeds of each financing tranche are measured at the C\$:US\$ conversion rate in effect at the date the funds are received.

and the US\$0.60597 per subscription receipt actually received (taking into account the issuance of the 10,272,252 private placement fee shares). The difference was calculated to be US\$0.0455, resulting in a value of US\$8.3 million (\$9.0 million using an exchange rate of 1.0898) for the derivative. The residual amount of \$110.9 million was recorded as a financial liability, which is accounted for at amortized cost and therefore accretes to the face value of the subscription receipts over the period from May 23rd to September 24, 2014 (this date being the outside date for conversion of the subscription receipts). Transaction costs were allocated on a pro-rata basis between the host and the derivative. On July 8, 2014 the embedded derivative was revalued using the same methodology as described above and the fair value of the derivative was calculated to be \$7.8 million. As at July 8, 2014, the carrying value of the liability related to the subscription receipts and the fair value of the derivative were transferred to share capital upon conversion of the subscription receipts into common shares of the Corporation in connection with the closing of the Financing Transactions.

Private Placement Subscription Receipts - Orion	Host	Derivative	Total
Initial proceeds (US\$110 million @ 1.0898)	110,872	9,006	119,878
Deduct: transaction fees*	(3,796)	-	(3,796)
Change in fair value of derivative	-	(994)	(994)
Change in foreign exchange	(2,257)	(173)	(2,430)
Accretion	4,543	-	4,543
Transferred to Share Capital upon conversion of Private Placement Subscription Receipts and issuance of Private Placement Fee Shares July 8, 2014	109,362	7,839	117,201

*Transaction fees of \$0.3 million related to the derivative were recognized in the Statement of Loss

ii) *Prospectus Offering*

The Corporation filed a final short form prospectus on May 12, 2014 to qualify the distribution of 188,600,000 Subscription Receipts at a price of \$0.70 per Subscription Receipt. Each Subscription Receipt was converted into one common share and one-half of one common share purchase warrant (a "Warrant") upon closing of the Financing Transactions on July 8, 2014. The prospectus offering was made pursuant to an underwriting agreement dated May 12, 2014 among the Corporation and a group of underwriters including Scotiabank, Dundee Capital Markets and RBC Capital Markets (collectively, the "Underwriters"), pursuant to which the Corporation agreed to issue and sell and the Underwriters agreed to purchase, as principals, at closing of the prospectus offering, subject to the conditions stipulated in the Underwriting Agreement, 188,600,000 Subscription Receipts at a price of \$0.70 per Subscription Receipt for total gross proceeds of \$132 million, to be held in escrow until the remainder of the Financing Transactions closed. Each Warrant entitles the holder to purchase one common share of the Corporation (each, a "Warrant Share") at a price of \$0.90 (the "Warrant Exercise Price"), for a period of 24 months following their date of issuance. The Warrant Exercise Price and the number of Warrant Shares issuable upon exercise will be subject to adjustment in certain circumstances. On July 8, 2014, the Subscription Receipts were converted into 188,600,000 common shares and 94,300,000 warrants and the gross proceeds of \$132 million from the prospectus offering, less a 5% commission of \$6.6 million, were released from escrow and paid to the Corporation.

iii) *Convertible Debentures*

On July 8, 2014, the Corporation issued Convertible Debentures for gross proceeds of \$86.7 million (US\$81.3 million converted to Canadian dollars at the July 8, 2014 exchange rate of 1.0674), before a discount to the purchasers of 4% (US\$3.3 million) of the principal amount. The Convertible Debentures will mature on July 8, 2021; there will be no principal repayments until the maturity date. Interest will accrue at a rate of 6.25% *per annum* from July 8, 2014, payable semi-annually on the last day of June and December of each year. In certain circumstances, the Corporation can satisfy the interest payment obligation through the issuance of common shares. The Convertible Debentures will rank (i) subordinate in right of payment to the payments of all secured obligations including Stream Net Proceeds to the Stream Buyers under the Streaming Agreement and payments required under the Senior Secured Loan, and (ii) *pari passu* with all outstanding unsecured indebtedness for borrowed money of Stornoway.

The Convertible Debentures are convertible at the holder's option into common shares of the Corporation at any time prior to the close of business on the earlier of the maturity date and the business day immediately preceding the date fixed for redemption thereof, at the Conversion Price, being US\$0.8863 for one common share, subject to adjustment in certain limited circumstances. The number of Common Shares issuable upon conversion of the Convertible Debentures, which are denominated in United States dollars, will be determined based on the Bank of Canada CAD/USD noon exchange rate on the business day prior to the date of conversion.

The Convertible Debentures are a hybrid instrument, which are in their entirety a financial liability. The initial carrying amount of \$48.8 million for the host represents the residual amount of the proceeds after separating out the \$34.4 million fair value of the derivative. Transaction costs were allocated on a pro-rata basis between the host and the derivative. The table below shows the change in the carrying value of the Convertible Debentures between initial recognition on July 8, 2014 and July 31, 2014:

	Host	Derivative	Total
Initial proceeds, net of 4% discount	48,831	34,433	83,264
Deduct: transaction fees*	(2,576)	–	(2,576)
Change in fair value of derivative	–	4,381	4,381
Change in foreign exchange	936	741	1,677
Accretion	189	–	189
Balance – end of the period	47,380	39,555	86,935

*Transaction fees of \$1.8 million related to the derivative were recognized in the Statement of Loss

The derivative was valued using a convertible bond valuation model. The following key assumptions were used in that model:

	As at July 8, 2014	As at July 31, 2014
Expected life in years	7.0	7.0
Expected volatility	59.9%	59.8%
Risk-free rate*	2.285%	2.351%
Credit spread	15.67%	16.54%
Change of control probability	0%	0%
Foreign exchange spot rate (CDN\$: USD)	1.0674	1.0890

*The risk-free rate is the zero coupon curve based on the US dollar swap rate.

Expected volatility was based on the Corporation's historical volatility for a seven year period and the volatility of an equity market index in the mining sector for the same period. To price the Convertible Debentures to par on the issuance date the credit spread was calibrated to 15.67%. The Corporation used the same methodology to estimate the fair value of the derivative on July 31, 2014, except that the credit spread was based on a US dollar index for triple-C bonds (7-10 years).

iv) *Diamond Stream Agreement*

On July 8, 2014, the SDCI entered into a diamond streaming agreement (the "Stream") with Orion and CDPQ (collectively, the "Stream Buyers"), pursuant to which SDCI shall sell to the Stream Buyers, and the Stream Buyers shall purchase from SDCI, a 20% undivided interest in each of the run of mine diamonds produced over the life of the Renard Diamond Project. The obligations of the Stream Buyers under the Streaming Agreement are several and not joint. The Streaming Agreement will apply to certain kimberlite bodies for the life of the Renard Diamond Project. The Streaming Agreement will provide that the Stream Buyers shall make up-front payments to SDCI, representing prepayment of a portion of the purchase price payable for a 20% interest in each diamond produced by the Renard Diamond Project, in an aggregate amount of US\$250 million (the "Deposit"), which shall be disbursed in three (3) installments with 30 days' notice as follows:

- The first deposit ("D1"): US\$80 million on the Initial Stream Deposit Date (expected to be March 2015);
- The second deposit ("D2"): US\$80 million during a period between four (4) months and six (6) months after the Initial Stream Deposit Date; and
- The third deposit ("D3"): US\$90 million during a period between ten (10) months and twelve (12) months after the Initial Stream Deposit Date.

Payment of each deposit is subject to SDCI meeting certain conditions precedent. SDCI will pay a 1% standby fee, quarterly in arrears, on the undisbursed deposits. Until the Deposits have been fully offset, the stream purchase price will be equal to the gross proceeds from the sale of the subject diamond interest, payable by payment of a US\$50 per carat cash price and the balance by offset against the Deposits. Once the Deposits have been fully offset, the stream purchase price will be equal to the US\$50 per carat cash price. The Streaming Agreement provides that until the Deposits have been fully offset, the Deposits shall be applied in satisfaction of such portion of the Streaming Purchase Price, if any, that exceeds the Per Carat Cash Price, such portion of the Streaming Purchase Price being satisfied by offset against the Deposits, and the Deposits shall thereupon be reduced by the amount of such excess. As at July 31, 2014, no amounts had been received pursuant to this agreement.

The Stream includes covenants customary for a facility of this nature, including the requirement to maintain a tangible net worth of not less than \$250 million and to advance to SDCI any proceeds from the exercise of subscriber warrants issued as part of the May 23, 2014 prospectus offering.

v) *Senior Secured Loan*

On July 8, 2014, SDCI and Diaquem, a wholly-owned subsidiary of RQ, entered into the Senior Secured Loan Agreement that will provide for an initial \$100 million of the Senior Secured Loan (the "Senior Secured Loan, Tranche A") with the possibility, at the option of SDCI, to increase the

loan up to an amount of the further \$20 million of the Senior Secured Loan (the “Senior Secured Loan, Tranche B”). The Senior Secured Loan will, at SDCI’s option, bear interest at (i) a floating rate equal to the most common prime rate announced by Schedule I Canadian banks, plus (a) prior to Completion (which will occur upon the delivery to Diaquem of various certifications related to physical facilities, production, operating costs/efficiency, marketing, legal and financial matters), 4.75% per annum, and (b) after Completion, 4.25% per annum, or (ii) subject to availability, at a fixed rate based on the then available Government of Québec bonds for any applicable periods plus (a) prior to Completion, 5.75% per annum, and (b) after Completion, 5.25% per annum. Interest will be paid in arrears at the end of each quarter. Under the Senior Secured Loan Agreement, SDCI will have the option, upon prior notice, to convert advances bearing interest at the floating rate to a fixed rate as detailed above. Upfront fees equal to 2.75% of the principal amount of the Senior Secured Loan, Tranche A and the Senior Secured Loan, Tranche B, are payable by SDCI, 25% of which was paid on July 8, 2014 and the remaining 75% of which shall be payable upon the initial funding date of the Senior Secured Loan, Tranche A (based on the full amount of Senior Secured Loan).

In addition, there will be a standby fee of 1.75% per annum, payable quarterly in arrears, on the daily undrawn principal amount of the Senior Secured Loan during the Availability Period (the Availability Period is the time between closing of the Financing Transactions and the first draw under the facility). SDCI must meet certain conditions precedent to be able to draw either Tranche A or Tranche B of the Senior Secured Loan. As at July 31, 2014, no amounts had been drawn under this facility.

The Senior Secured Loan includes covenants customary for a transaction of this nature, including the following financial covenants:

- i) Maintaining a reserve tail ratio of at least 28%;
- ii) Maintaining a historical debt service coverage ratio in respect of the immediately preceding four quarter period greater than or equal to 1.25:1.0 at all times following Completion;
- iii) Maintaining a projected debt service coverage ratio greater than or equal to 1.25:1.0 at all times following Completion; and
- iv) Until the Parental Support Termination Date (which is the later to occur of):
 - i) Completion, and
 - ii) the repayment of 50% of the principal amount borrowed,
 the Corporation must maintain a tangible net worth, on a consolidated basis, of \$250 million; after the Parental Support Termination Date, SDCI must maintain a tangible net worth, on a consolidated basis, of \$250 million.

vi) *Cost Over-run Facility*

On July 8, 2014, the Corporation and CDPQ entered into the COF Agreement, whereby, under certain terms and conditions, CDPQ will provide up to \$28 million as a cost over-run facility to be used for the development of the Renard Diamond Project. The COF will bear interest at a rate of 10.0% *per annum* payable from the first date the COF is drawn, payable semi-annually on the last day of June and December of each year; the COF will mature seven years from the date it is drawn. In certain circumstances, the Corporation may satisfy its obligation to pay interest under the terms of the COF Agreement by issuing common shares. The COF will rank (i) subordinate in right of payment to the payment of all secured obligations, including Stream Net Proceeds to the Stream Buyers under the Streaming Agreement and payments required under the Senior Secured Loan and (ii) *pari passu* with all outstanding unsecured indebtedness for borrowed money of Stornoway. A standby fee of 1.00% *per annum* will be payable by the Corporation on

undrawn amounts. As at July 31, 2014, no amounts had been drawn under this facility. The COF agreement includes covenants customary for a transaction of this nature.

vii) *Equipment Finance Facility*

On July 25 2014, SDCI and Caterpillar Financial SARL (“Caterpillar”) entered into an equipment finance facility of US\$ 75 million for the purchase of CAT and non-CAT equipment. Tranche A is a maximum amount of US\$50 million, less upfront payments ranging from 15% to 50% based on the type of equipment financed (the estimated financing available under this facility after upfront deposits is expected to be approximately US\$35 million); Tranche B is a maximum amount of US\$25 million, less upfront payments. The term of the facility is six years from the date of each drawdown and the facility is secured by the equipment financed. Interest is payable at 3 month US LIBOR plus 4%. As at July 31, 2014, no amounts had been drawn under this facility. Covenants in the equipment finance facility include: i) a reserve tail ratio of 25% if there is any indebtedness under Tranche A of the facility (20% if the only amounts outstanding are under Tranche B); historical and projected debt service coverage ratios greater than or equal to 1:15:1.0; and iii) a requirement for the Corporation, on a consolidated basis, to maintain a tangible net worth of \$250 million.

Use of Proceeds – Financing Transactions

The following table presents the anticipated use of proceeds from the Financing Transactions and compares previously stated assumptions to actual use of proceeds:

		Actual use of proceeds as at
<i>(all amounts expressed in thousands of Canadian dollars)</i>	Assumed	July 31, 2014
<i>Renard Diamond Project</i>		
Capital Expenditures	811	24
Route 167 Extension	70	70
Loan Principal Payments during Construction	19	-
Interest (cash) during Construction	20	-
Debt Financing Costs and Stream Commitment Fee	19	3
Mine Closure Guarantee	16	-
Pre-production Net Revenue	(26)	-
<i>Total Project Costs</i>	929	97
<i>General Corporate Purposes</i>		
Equity fees and transaction costs	18	13
General working capital, administrative and salary expenses	14	-
Total Uses	961	110

Mine construction activities started on July 10, 2014. Significant target milestones during calendar year 2014 include: completion of early works at the project site; commencement of detailed engineering and the preparation of bid packages for long-lead and major items; installation of temporary camp facilities immediately following the commencement of construction to facilitate the building and installation of

permanent camp facilities later in 2014, completion of the Renard Mine Road and Renard Mine Airport for year-round use; building a concrete batch plant; and installing a raw water intake and pumphouse.

Mine construction activities started on July 10, 2014 and will continue for approximately 27 months, with a further 6 to 9 months required for plant commissioning until commercial production is achieved in 2017. The majority of construction related expenditures will be incurred in 2015 and 2016. See “Construction Highlights” in the section “Material Mineral Project – Renard Diamond Project, Québec” below for more details.

Commitments

As at July 31, 2014, the Corporation is committed to minimum future principal and interest payments for Debt and Convertible Debentures, as follows (refer to Notes 7 and 8 of the interim condensed consolidated financial statements for the three months ended July 31, 2014 for additional details):

	Unsecured debt facility (# 1)	Unsecured debt facility (# 2)	Other unsecured debt	Renard mine road debt facility	Convertible debentures	Total
Nine months ending April 30, 2015	610 *	–	561	–	2,667	3,838
Year ending April 30, 2016	1,200 *	–	694	–	5,531	7,425
Year ending April 30, 2017	7,052	–	916	6,000	5,531	19,499
Year ending April 30, 2018	5,594	31,487 **	1,571	6,000	5,531	50,183
Year ending April 30, 2019	5,130	–	1,571	6,000	5,531	18,232
Thereafter	9,518	–	13,750	79,450	102,413	205,131
	29,104	31,487	19,063	97,450	127,204	304,308

* The \$2.4 million interest payment is payable 100% in cash or 50% in cash and 50% in the Corporation’s common shares, at the Corporation’s option, prior to commencement of commercial production. The assumption in the table above is that only 50% is paid in cash in 2015 and 2016.

** Maturity of this debt will occur on the earlier of: i) closing of Tranche A of the Senior Secured Loan (anticipated to take place in the fourth quarter of calendar 2016) and ii) June 30, 2017.

As at July 31, 2014, the Corporation had the following other commitments for operating leases and financing fees:

	Operating Lease Payments	Financing Fees	Total
Nine months ending April 30, 2015	285	4,673	4,958
Year ending April 30, 2016	273	6,253	6,526
Year ending April 30, 2017	230	2,516	2,746
Year ending April 30, 2018	114	1,726	1,840
Year ending April 30, 2019	78	–	78
Thereafter	–	–	–
	980	15,168	16,148

Impact and Benefits Agreement

In March 2012, the Corporation entered into an impacts and benefits agreement (the “Mecheshoo Agreement”) for the Renard Diamond Project with the Cree Nation of Mistissini and the Grand Council of the Crees (Eeyou Istchee)/Cree Regional Authority. The Mecheshoo Agreement is a binding agreement that will govern the long-term working relationship between the Corporation and the Cree

parties during all phases of the Renard Diamond Project. It provides for training, employment and business opportunities for the Cree during project construction, operation and closure, and sets out the principles of social, cultural and environmental respect under which the project will be managed. The Mecheshoo Agreement includes a mechanism by which the Cree parties will benefit financially from the success of the project on a long term basis, consistent with the mining industry's best practices for engagement with First Nations communities.

Royalty

The Renard Diamond Project is subject to a 2% royalty interest on diamond production (calculated as 2% of the actual gross selling price in Canadian dollars, minus the lesser of: 3% marketing costs and the actual diamond selling costs) and a 2% NSR on other mineral production.

Financing Fees

In connection with the Financing Transactions described in Note 14, the Corporation and SDCI have agreed to pay a 1% *per annum* standby fee upon undisbursed amounts pursuant to each of the Stream and the COF and a 1.75% *per annum* standby fee is payable upon the undrawn principal amount of the Senior Secured Loan. A standby fee is also payable upon undisbursed amounts under the equipment finance facility. In addition, SDCI has agreed to pay an upfront fee of 2.75% of the Senior Secured Loan amount, 25% of which was paid on July 8, 2014 (\$0.8 million) and the balance of which will be payable at the initial funding date of the Senior Secured Loan (anticipated to occur in 2016) and an arrangement fee pursuant to the terms of the equipment finance facility, 25% of which was paid July 25, 2014 (\$0.4 million).

The Corporation will also have semi-annual interest payment obligations pursuant to the Convertible Debentures issued July 8, 2014 as well as other interest payment obligations in connection with outstanding indebtedness as at July 31, 2014 (see table above for details).

Financial Guarantee

SDCI is required to provide a financial guarantee to the Québec government of \$15.2 million with respect to the Closure Plan for the Renard Diamond Project which was approved in December 2012. The first installment of \$7.6 million was made in August 2014; the second and third installments of \$3.8 million each are due in August 2015 and 2016 respectively. The Corporation arranged a surety bond for the financial guarantee which can be increased for the subsequent installments in 2015 and 2016. In connection with the surety bond, SDCI provided cash collateral of \$1.5 million to the underwriter of the surety bond.

Other Commitments

In connection with the commencement of construction activities at the Renard Diamond Project on July 10, 2014, SDCI has entered into a number of contracts for goods and services, including an engineering, procurement and construction management ("EPCM") contract. These contracts will require ongoing payments. In addition, as at July 31, 2014, SDCI has placed deposits totalling \$2.8 million for long-lead items. As at July 31, 2014, SDCI had commitments of \$91.5 million for the purchase of property, plant and equipment.

OUTSTANDING SHARE CAPITAL

Stornoway's authorized capital is an unlimited number of common shares. In certain circumstances, the Corporation may be required to issue common shares upon conversion of the Convertible Debentures (see "Convertible Debentures" discussion above for details).

As at September 9, 2014, there were 730,949,299 common shares issued and outstanding.

Stock Option Plan

The maximum number of common shares issuable pursuant to the Corporation's Stock Option Plan is 10% of the issued and outstanding common shares and non-voting convertible shares.

As at September 9, 2014, the following stock options are outstanding:

Range of Exercise Prices	Number of Options Outstanding	Weighted Average Exercise Price (per share/option)	Weighted Average Remaining Contractual Life
\$0.40 – \$0.71	22,808,750	\$0.70	4.80 years
\$0.77 – \$1.04	3,008,750	\$1.00	2.12 years
\$2.24 – \$2.60	1,043,750	\$2.30	1.10 years
\$3.84 – \$4.32	47,500	\$4.12	0.90 years
\$5.36	6,250	\$5.36	0.55 years
	26,915,000	\$0.81	4.40 years

As at September 9, 2014, the following warrants are outstanding:

Number of Warrants	Exercise Price (per warrant)	Expiry Date
529,000	0.95	December 3, 2015
94,300,000	0.90	July 8, 2016
15,000,000	1.21	May 3, 2017
14,000,000	0.945	July 8, 2019
123,829,000		

TRANSACTIONS WITH RELATED PARTIES

A complete description of transactions with related parties, including key management personnel remuneration for the three months ended July 31, 2014 and July 31, 2013 can be found in Note 10 of the condensed interim consolidated financial statements for the three months ended July 31, 2014.

During the three months ended July 31, 2014, the Corporation entered into several significant transactions with Orion and IQ and its affiliates, both investors that have significant influence over the Corporation:

- Orion provided financing to the Corporation through the purchase of US\$110 million in equity and US\$20.5 million of convertible debentures. In connection with these transactions, the

Corporation incurred various financing costs and also reimbursed Orion for legal expenses of \$1.7 million, as negotiated in connection with the Financing Transactions. Following these transactions, Orion owns 24.8% of the Corporation's issued and outstanding common shares and 25.2% of the Corporation's outstanding convertible debentures, which can be converted into common shares of the Corporation under certain circumstances (see "*Convertible Debentures*" under "*Completed Financings – Three Months Ended July 31, 2014*" above. In addition, Orion exercised its right to have a nominee appointed to the Corporation's Board of Directors on July 8, 2014. Accordingly, Orion has significant influence over the Corporation.

- The Corporation received financing from and incurred interest, commitment fees and standby fees payable to IQ and its affiliates RQ and Diaquem. Collectively, these entities own 28.7% of the Corporation's issued and outstanding common shares. In addition, Diaquem holds \$25 million of the Corporation's long-term debt. In connection with the terms of the Financing Transactions, the Corporation paid legal fees of \$0.8 million on IQ's behalf. Under the terms of the Amended and Restated Investor Agreement dated July 8, 2014, IQ continues to have the right, which it has exercised, to nominate three individuals to the Corporation's Board of Directors. Accordingly, IQ and its affiliates have significant influence over the Corporation.

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

During the Current Period, new significant estimates relate to estimates used to determine the fair value of the embedded derivatives within the convertible debentures and the subscription receipts denominated in US dollars. A description of the critical accounting estimates and judgments for the three months ended July 31, 2014 can be found in Note 3 of the condensed interim consolidated financial statements for the three months ended July 31, 2014.

CHANGES IN ACCOUNTING POLICIES

During the Current Period, the Corporation adopted accounting policies for compound instruments, embedded derivatives and earnings per share due to the Financing Transactions which were concluded on July 8, 2014. A description of these new accounting policies adopted by the Corporation can be found in Note 2b of the condensed interim consolidated financial statements for the three months ended July 31, 2014.

NEW ACCOUNTING STANDARDS AND INTERPRETATIONS

A description of the new accounting standards and interpretations adopted by the Corporation as of May 1, 2014 can be found in Note 2c of the condensed interim consolidated financial statements for the three months ended July 31, 2014.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

A description of the Corporation's financial instruments and risk management practises, as well as an analysis of the financial risks which affect the Corporation can be found in Note 4 of the condensed interim consolidated financial statements for the three months ended July 31, 2014.

MATERIAL MINERAL PROJECT– Renard Diamond Project, Québec

Stornoway's principal mineral property and primary focus is the Renard Diamond Project, part of the larger Foxtrot Property in the Otish Mountains located in Québec, Canada. Stornoway's wholly-owned subsidiary SDCI has a 100% interest in the Foxtrot Property, which contains the Renard cluster of kimberlite bodies. Diaquem, an indirect wholly-owned subsidiary of IQ, has a 2% gross revenue royalty on life of mine production from Renard. The Renard Diamond Project is located approximately 250 km north of the Cree community of Mistissini and 350 km north of Chibougamau in the James Bay region of North-Central Québec. In July 2014, as part of the Financing Transactions, SDCI entered into a diamond streaming agreement pursuant to which SDCI will sell a 20% undivided interest in each of the run of mine diamonds produced over the life of the Renard Diamond Project. See *"Completed Financings – Three months ended July 31, 2014"* above for additional details.

In November 2011, Stornoway released the results of a Feasibility Study at Renard, followed by an Optimization Study in January 2013, which highlighted the potential of the project to become a significant producer of high value rough diamonds over a long mine life. Probable Mineral Reserves as defined under NI 43-101 stand at 17.9 million carats. Total Indicated Mineral Resources, inclusive of the Mineral Reserve, stand at 27.1 million carats, with a further 16.9 million carats classified as Inferred Mineral Resources, and 25.7 to 47.8 million carats classified as non-resource exploration upside. All kimberlites remain open at depth. Readers are referred to the technical report dated December 29th, 2011 in respect of the November 2011 Feasibility Study (the "2011 Feasibility Study") for the Renard Diamond Project, and the technical report dated February 28th, 2013 in respect of the January 2013 Optimization Study (the "Optimization Study"), for further details and assumptions relating to the project.

Updated Mine Production Schedule and Budget

The project development schedule contained within the Optimization Study contemplated project construction mobilization starting in August 2013, with plant commissioning beginning in December 2015 and commercial production to be achieved by June 2016. The Corporation anticipates an approximate 12-month shift to this schedule, with the project released for construction in July 2014, plant commissioning beginning in Q3 2016 and commercial production expected to be achieved in Q2 2017. This shift in schedule is expected to result in an estimated increase of \$10.6 million in the project's capital cost estimate that was contained within the Optimization Study, and as subsequently adjusted in the LNG Study, based on cost escalation factors currently in use in Québec. The current capital cost to develop the Renard Diamond Project, including contingencies and escalation, is estimated to be \$811 million.

Construction Highlights

A formal decision by the Corporation's Board of Directors to proceed to project construction was announced on July 10th at a ground breaking ceremony held in the presence of Philippe Couillard, Premier of Québec. Since then, construction mobilization has proceeded rapidly with no major variances forecast to date against the planned schedule or budget. Site activities have focussed on the construction of dry pads at the principal surface facilities such as the permanent accommodation complex, process plant, power plant, machine shops and lay downs. A large borrow pit for construction aggregate has been established within the planned Renard 65 open pit area. Work has commenced on the surface water management ditches, the potable water intake system and waste water treatment facilities, with temporary mine water treatment facilities commissioned and operational. Final gravel top

coats have been completed on the Renard Mine Road and the airport, which is now receiving large aircraft.

Temporary construction camps have been established with 250 beds, comprising 110 beds at site and 140 beds at two nearby road construction camps. Onsite manpower averaged 150 persons in August and is forecast to average 235 persons in September. Full completion of a 325 bed permanent accommodation complex and mine office is expected by the end of March 2015 ahead of major facilities construction beginning in April 2015. First ore is expected to be delivered to the plant in the second calendar half of 2016, in support of commercial production by the second calendar quarter of 2017.

Purchase orders or letters of intent have been issued for certain time-sensitive long lead items including the High Pressure Grinding Rolls ("HPGR"), jaw and cone crushers, high capacity thickeners, diamond recovery equipment, LNG generators and for certain underground and surface mining vehicles. Given the current environment for mine construction, SDCI does not currently anticipate delays in the receipt of any critical equipment.

Site construction is proceeding under a contract for EPCM with SNC-Lavalin. SNC-Lavalin is providing EPCM services for on-site utilities such as the liquid natural gas power plant, the processing plant building, service buildings, water treatment facilities, and on-site infrastructure. The agreement with SNC-Lavalin incorporates sub-contracted services by AMEC and DRA who are providing certain specialized engineering and field support services relating to the project's diamond processing plant and diamond recovery circuits.

Resource Drilling Highlights

On April 15th 2014 the Corporation announced the commencement of a resource expansion drill program focussed on the conversion of Inferred Mineral Resources at the Renard 2 kimberlite between 600 and 700 meters depth, and exploration below 700 meters with deep directional drilling. Currently, three rigs are drilling at site and to date over 8,000 meters of drilling has been completed. On August 25th 2014 the Corporation announced that multiple intersections of each of the characteristic phases of diatreme intrusion at Renard 2, as well as the pipe's marginal country rock breccias, have been confirmed between 600 meters and a minimum 970 meters below surface, indicating that the kimberlite is maintaining its emplacement style and substantial tonnage potential over this full vertical depth. Drilling at site is expected to continue into October, to be followed by diamond recovery by caustic dissolution and mini-bulk sampling by dense media separation (DMS) at Microlithics Laboratories in Thunder Bay, Ontario. The resulting geological and diamond content data will be used to update the Renard 2 geological and grade distribution model in support of an updated Mineral Resource statement scheduled for completion during Q2 2015.

RISKS AND UNCERTAINTIES

The operating results and financial condition of the Corporation are subject to a number of inherent risks and uncertainties associated with its business activities, which include the development and construction of a mine and related infrastructure at the Renard Diamond Project, as well as exploration and financing activities. The operating results and financial conditions are also subject to numerous external factors which include geo-political, regulatory, legal, tax and market risks impacting, among other things, diamond prices, commodity prices, foreign exchange rates, inflation, the availability and cost of both qualified personnel with experience in the construction and mining industries, the availability and cost of materials required to build a mine and related infrastructure and the Renard

Diamond Project and the availability and cost of capital. Each of these risks could have a material adverse effect on the Corporation's ability to develop a mine and related infrastructure at the Renard Diamond Project, as well as the Corporation's ability to achieve commercial production and generate positive cash flow from operations. These risks could have a material adverse effect on the Corporation's future business, results of operations and financial condition, and could cause actual results to differ materially from those described in any forward-looking statements in this MD&A. The Corporation's objective is to mitigate risks and uncertainties in a balanced manner whilst still maximizing shareholder value. It is the responsibility of senior management to identify and effectively manage the Corporation's risk. This involves developing appropriate risk management strategies, policies, processes and systems. There can be no assurance that the Corporation will be successful in identifying all risks or that any risk mitigation strategies will be sufficient to reduce or eliminate risk.

A comprehensive discussion of the risks faced by the Corporation can be found in the Corporation's Annual Information Form dated July 24, 2014.

DISCLOSURE CONTROLS

The Corporation's disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is communicated to senior management, to allow timely decisions regarding required disclosure.

An evaluation of the effectiveness of the Corporation's disclosure controls and procedures, as defined under the rules of the Canadian Securities Administration, was conducted as of April 30, 2014 under the supervision of the Corporation's management. Based on the results of that evaluation, the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") concluded that the Corporation's disclosure controls and procedures were effective in providing reasonable assurance that the information required to be disclosed in the Corporation's annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported as required by applicable securities legislation.

Since the April 30, 2014 evaluation, there have been no adverse changes to the Corporation's disclosure controls and procedures, there have been no material weaknesses relating to the design of the disclosure controls and procedures as at and for the three months ended July 31, 2014 and there are no limitations on the scope of design to be disclosed in this interim MD&A.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

Internal controls over financial reporting ("ICFR") as defined by National Instrument ("NI") 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*, have been designed by the Corporation's management, under the supervision of the CEO and CFO, based on the Internal Control – Integrated Framework (1992) developed by the Committee of Sponsoring Organizations of the Treadway Commissions ("COSO"). ICFR are designed to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and the preparation of financial statements in compliance with IFRS. Due to the inherent limitations associated with any such controls and procedures, management recognizes that no matter how well internal controls are designed and operated, they may not prevent or detect misstatements on a timely basis.

The Corporation's ICFR include policies and procedures that:

- pertain to the maintenance of records that accurately and fairly reflect the transactions of the Corporation;

- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS;
- ensure the Corporation's receipts and expenditures are made only in accordance with authorization of management and the Corporation's directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized transactions that could have a material effect on the annual or interim financial statements.

An evaluation of the effectiveness of the Corporation's ICFR was conducted as of April 30, 2014 by the Corporation's management, including the CEO and CFO. Based on this evaluation, management concluded that the Corporation's internal controls over financial reporting were effective as at and for the year ended April 30, 2014.

NI 52-109 also requires Canadian public companies to disclose any change in ICFR during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect ICFR. Since the April 30, 2014 evaluation, there have been no adverse changes to the Corporation's ICFR, there have been no material weaknesses relating to the design of ICFR as at and for the three months ended July 31, 2014 and there are no limitations on the scope of design of ICFR to be disclosed in this interim MD&A.

CAUTIONARY NOTE TO UNITED STATES INVESTORS CONCERNING ESTIMATES OF MEASURED, INDICATED AND INFERRED RESOURCES

This MD&A uses the terms "Measured", "Indicated" and "Inferred" Mineral Resources. United States investors are advised that while such terms are recognized and required by Canadian regulations, the U.S. Securities and Exchange Commission ("SEC") does not recognize them. "Inferred Mineral Resources" have a great amount of uncertainty as to their existence and as to their economic and legal feasibility. It cannot be assumed that all or any part of an Inferred Mineral Resource will ever be upgraded to a higher category. Under Canadian rules, estimates of Inferred Mineral Resources may not form the basis of feasibility or pre-feasibility studies. **United States investors are cautioned not to assume that all or any part of Measured or Indicated Mineral Resources will ever be converted into Mineral Reserves. United States investors are also cautioned not to assume that all or any part of an Inferred Mineral Resource exists, or is economically or legally mineable.**

FORWARD-LOOKING STATEMENTS

This MD&A contains "forward-looking information" within the meaning of Canadian securities legislation. This information and these statements, referred to herein as "forward-looking statements", are made as of the date of this MD&A and the Corporation does not intend, and does not assume any obligation, to update these forward-looking statements, except as required by law.

Forward-looking statements relate to future events or future performance and reflect current expectations or beliefs regarding future events and include, but are not limited to, statements with respect to: (i) the amount of mineral resources and exploration targets; (ii) the amount of future production over any period; (iii) net present value and internal rates of return of the mining operation; (iv) assumptions relating to recovered grade, average ore recovery, internal dilution, mining dilution and other mining parameters set out in the Feasibility Study or the Optimization Study; (v) assumptions relating to gross revenues, operating cash flow and other revenue metrics set out in the Feasibility Study or the Optimization Study; (vi) mine expansion potential and expected mine life; (vii) expected time frames for completion of permitting and regulatory approvals; (viii) the expected time frames for the construction of a mine and related infrastructure and the financial obligations or costs incurred by

Stornoway in connection with such mine development; (ix) future exploration plans; (x) future market prices for rough diamonds; (xi) the economic benefits of using liquefied natural gas rather than diesel for power generation; (xii) sources of and anticipated financing requirements; (xiii) the effectiveness of the various elements of the Financing Transactions and the use of proceeds therefrom; and (xv) the impact of the Financing Transactions on the Corporation's operations, infrastructure, opportunities, financial condition, access to capital and overall strategy. Any statements that express or involve discussions with respect to predictions, expectations, beliefs, plans, projections, objectives, assumptions or future events or performance (often, but not always, using words or phrases such as "expects", "anticipates", "plans", "projects", "estimates", "assumes", "intends", "strategy", "goals", "objectives", "schedule" or variations thereof or stating that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved, or the negative of any of these terms and similar expressions) are not statements of historical fact and may be forward-looking statements.

Forward-looking statements are made based upon certain assumptions by Stornoway or its consultants and other important factors that, if untrue, could cause the actual results, performances or achievements of Stornoway to be materially different from future results, performances or achievements expressed or implied by such statements. Such statements and information are based on numerous assumptions regarding present and future business prospects and strategies and the environment in which Stornoway will operate in the future, including the price of diamonds, anticipated costs and Stornoway's ability to achieve its goals, anticipated financial performance, regulatory developments, development plans, exploration, development and mining activities and commitments. Although management considers its assumptions on such matters to be reasonable based on information currently available to it, they may prove to be incorrect. Certain important assumptions by Stornoway in making forward-looking statements include, but are not limited to: (i) required capital investment and estimated workforce requirements; (ii) estimates of net present value and internal rates of return; (iii) receipt of regulatory approvals on acceptable terms within commonly experienced time frames; (iv) anticipated timelines for the construction phase; (v) anticipated timelines for the commencement of mine production; (vi) anticipated timelines related to the completion of the Route 167 extension and the impact on the development schedule at Renard; (vii) market prices for rough diamonds and the potential impact on the Renard Diamond Project; and (viii) future exploration plans and objectives. Additional risks are described in Stornoway's most recently filed Annual Information Form dated July 24, 2014 and other disclosure documents available under the Corporation's profile at: www.sedar.com.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that estimates, forecasts, projections and other forward-looking statements will not be achieved or that assumptions do not reflect future experience. We caution readers not to place undue reliance on these forward-looking statements as a number of important risk factors could cause the actual outcomes to differ materially from the beliefs, plans, objectives, expectations, anticipations, estimates, assumptions and intentions expressed in such forward-looking statements. These risk factors may be generally stated as the risk that the assumptions and estimates expressed above do not occur, including the assumption in many forward-looking statements that other forward-looking statements will be correct, but specifically include, without limitation, (i) risks relating to variations in the grade, kimberlite lithologies and country rock content within the material identified as mineral resources from that predicted; (ii) variations in rates of recovery and breakage; (iii) the uncertainty as to whether further exploration of exploration targets will result in the targets being delineated as mineral resources; (iv) developments in world diamond markets; (v) slower increases in diamond valuations than assumed; (vi) risks relating to fluctuations in the Canadian dollar and other currencies relative to the US dollar; (vii) increases in the costs of proposed capital and operating expenditures; (viii) increases in financing costs or adverse changes to the terms of available financing if

any; (ix) tax rates or royalties being greater than assumed; (x) uncertainty of results of exploration in areas of potential expansion of resources; (xi) changes in development or mining plans due to changes in other factors or exploration results; (xii) changes in project parameters as plans continue to be refined; (xiii) risks relating to the receipt of regulatory approvals or the implementation of the existing Impact and Benefits Agreement with aboriginal communities; (xiv) the effects of competition in the markets in which Stornoway operates; (xv) operational and infrastructure risks; (xvi) execution risk relating to the completion of the Route 167 extension and the construction of a diamond mine at Renard; (xvii) future sales or issuances of Common Shares lowering the Common Share price and diluting the interest of existing shareholders; (xviii) Stornoway being unable to meet its diamond delivery obligations under the purchase and sale agreement for the forward sale of diamonds, (xiv) Stornoway's ability to comply with its obligations under the various agreements forming part of the Financing Transaction and to draw on the funding available under those financing elements, and (xx) the additional risks described in Stornoway's Annual Information Form dated July 24, 2014, and Stornoway's anticipation of and success in managing the foregoing risks. Stornoway cautions that the foregoing list of factors that may affect future results is not exhaustive, and new, unforeseeable risks may arise from time to time.