

# **NAUTILUS MINERALS INC.**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*(US dollars, in accordance with Canadian GAAP)*

The following Management Discussion and Analysis ("MD&A") has been prepared as at November 11, 2011 for the nine months ended September 30, 2011. It includes references to United States dollars, Canadian dollars, Papua New Guinea kina, United Kingdom pounds sterling and euros. All dollar amounts referenced, unless otherwise indicated, are expressed in United States dollars and the Canadian dollars are referred to as C\$, Papua New Guinea kina are referred to as PGK, United Kingdom pounds sterling are referred to as £ and euros are referred to as €.

The MD&A of Nautilus Minerals Inc. (the "Company", "NMI" or "Nautilus") should be read in conjunction with the Company's unaudited consolidated financial statements for the nine months ended September 30, 2011, and related notes thereto (the "Third Quarter 2011 Financial Statements") which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). This MD&A should also be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2010, and the related notes thereto (the "2010 Financial Statements") which were prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") as at December 31, 2010 and the related annual management's discussion and analysis and the Annual Information Form on file with the Canadian provincial and territorial securities regulatory authorities.

Amounts for the nine and three month periods ended September 30, 2011 and 2010 have been presented in accordance with IFRS. Further, certain amounts for the nine and three month period ended September 30, 2010 have been restated from prior publicly disclosed amounts due to the transition to IFRS. Unless otherwise indicated, all amounts in this MD&A are in accordance with IFRS

This section contains forward-looking statements that involve risks and uncertainties. The Company's actual results may differ materially from those discussed in forward-looking statements as a result of various factors, including, but not limited to those described under "Forward-Looking Information."

### **FORWARD-LOOKING INFORMATION**

This MD&A contains certain forward-looking statements and information relating to the Company within the meaning of securities legislation. These forward looking statements are made as of the date of this MD&A and are based on the beliefs as well as assumptions of its management and information currently available to the Company. The Company does not intend, and does not assume any obligation, to update these forward-looking statements unless required by applicable law.

Forward-looking statements include, but are not limited to, statements with respect to the future price of copper, gold and other metals, the estimation of mineral resources, the realization of mineral resource estimates, the amount budgeted for exploration work in 2011 on the Solwara 1 Project and other regional exploration programs, the timing and amount of estimated future production, costs of production, costs and timing of the development of new deposits, success of exploration and development activities, permitting time lines, currency fluctuations, requirements for additional capital, government regulation of exploration operations, environmental risks, unanticipated reclamation expenses, title disputes or claims, the Company's financial position, business strategy, plans and objectives of management for future operations, the features and

performance of the PSV, SPTs and RALS, the purchase of the PSV, the dates of delivery of the PSV, the SPTs and the RALS, the average annual return paid by the Vessel JV, the completion of the pump design, the preparation of the Project Environmental Management Plans and limitations on insurance coverage. In certain cases, forward-looking statements can be identified by the use of words such as "plans", "expects" or "does not expect", "is expected", "budget", "scheduled", "estimates", "forecasts", "intends", "anticipates" or "does not anticipate", or "believes", or variations of such words and phrases or statements that certain actions, events or results "may", "could", "would", "might" or "will be taken", "occur" or "be achieved". Forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Such factors include, among others, risks related to joint venture operations; actual results of current exploration activities; changes in project parameters as plans continue to be refined; future prices of copper, gold and other metals; possible variations in resources, grade or recovery rates; late delivery of the PSV, SPTs, RALS or other equipment; variations in the cost of the PSV, SPTs, RALS or other equipment; variations in exchange rates; the failure to obtain the required equity funding or to obtain the approval of the TSX; Harren or Nautilus failing to secure required debt funding; changes in the cost of fuel and other inflationary factors; failure of plant, equipment or processes to operate as anticipated; accidents, labour disputes and other risks of the mining industry; delays in the completion of development or construction activities.

Such forward-looking statements are current only as at the date of this MD&A and are based on numerous material factors or assumptions (that management believes were reasonable at the time they are made) regarding the Company's present and future business strategies and the environment in which the Company will operate in the future, including the Company's continued compliance with regulatory requirements, the charter rate for the Company's vessels including the ore-transport barges, the proposed mine plan, the estimated cost and availability of funding for the continued exploration of the Company's tenements, continued productive relationships with the State of PNG and Harren & Partner and the good faith performance of the obligations of counterparties pursuant to contracts with the Company. In making the forward-looking statements in this MD&A, the Company has applied several material assumptions, including, but not limited to, the assumption that: (1) market fundamentals will result in sustained copper and gold demand and prices; (2) the proposed development of its mineral projects will be viable operationally and economically and proceed as expected; and (3) any additional financing needed will be available on reasonable terms. Other assumptions are discussed under "Risk Factors" in the Company's most recent Annual Information Form AIF.

Although the Company has attempted to identify important factors that could cause actual results to differ materially, the assumptions made may not prove to be correct or there may be unknown risks, uncertainties and other important factors beyond the Company's control that could cause the actual results, performance or achievements of the Company to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements.

## **OUR BUSINESS**

### **Overview**

Nautilus is a seafloor resource exploration and development company and the first company to commercially explore the ocean floor for copper, gold, silver and zinc deposits. Nautilus holds mineral licences and has submitted exploration applications in various locations in the Pacific Ocean and is establishing a pipeline of prospects for development. The Company's main focus is on developing a seafloor production system that can be used to extract resources from its seafloor prospects. The system will be applied to its first development, the Solwara 1 Project, located in the Bismarck Sea in the exclusive economic zone of Papua New Guinea ("PNG").

Nautilus' seafloor production system has the potential to open a new frontier of resource development as land-based mineral deposits continue to be depleted. With the Solwara 1 Project, Nautilus plans to become the world's first seafloor producer of copper and gold.

### **THIRD QUARTER 2011 HIGHLIGHTS**

- Nautilus awarded exploration tenements in the Eastern Pacific
- Nautilus awarded exploration tenements in Fiji
- C\$98.1 million raised in private placement
- Solwara 1 project development progressing
- Bismarck Sea exploration program achieves encouraging results
- \$155.1 million (equivalent) in cash and cash equivalents as at September 30, 2011 with second tranche of C\$27.6 million from private placement received on October 6, 2011

#### **Nautilus awarded exploration tenements in Eastern Pacific**

On July 22, 2011 Nautilus Minerals' wholly owned Tongan subsidiary, Tonga Offshore Mining Ltd. ("TOML"), became one of the first private sector organizations to be granted exploration licences in the highly prospective Clarion Clipperton Zone ("CCZ") of the Eastern Pacific.

Sponsored by the Tongan Government, TOML has been granted approximately 75,000 km<sup>2</sup> of prime exploration territory in the CCZ, which lies in international waters between Hawaii and Mexico.

As a result of exploration conducted in the 1980s, the CCZ is known to host significant deposits of polymetallic nodules, which are, rich in copper, nickel, manganese and cobalt, lying on the seafloor in water depths starting at 4,500 metres.

The International Seabed Authority, which is the organization responsible for administering activity on the seafloor in international territory, granted the TOML licence at its annual meeting in Jamaica in July. The licence is for an initial period of 15 years.

#### **Nautilus awarded exploration tenements in Fijian waters**

On August 11, 2011, Nautilus announced it had become the first private sector organisation to be granted offshore exploration licences in Fiji.

The Fijian Government granted the company 14 special prospecting licences, covering a total of approximately 60,000 km<sup>2</sup>. The territory is considered highly prospective, having been the subject of marine research by Japanese, French and other scientific cruises in the late 1980s and early 1990s. The licences each have an initial term of two years.

Under the terms of a regional area of interest agreement signed with Teck Resources in 2007, Teck holds the right to earn an interest in the Fijian tenements by contributing to exploration spending. Teck is expected to advise the Company during Q1 2012 whether it intends to exercise that right.

#### **C\$98.1 million raised in private placement**

On August 31, 2011, Nautilus announced a private placement of common shares for C\$98.1 million to fund the development of its first project, Solwara 1, in the Bismarck Sea of Papua New

Guinea.

The placement involved the issue of approximately 39 million shares in two tranches to a number of investors at a price of CAD\$2.52 per share.

Investors participating in the placing included Mawarid Mining LLC, a subsidiary of MB Holdings Company LLC, an oil and gas, mineral mining and processing group based in Muscat, Oman. It acquired a 9.98% of the expanded share capital of the company.

Nautilus has granted an anti-dilution right to the investors in this placement that will enable them to maintain their percentage ownership in the shares of Nautilus, as and when and at the price at which any common shares, or securities convertible into or exercisable for common shares, are issued by Nautilus until the earlier of the date of commencement of first production and February 28, 2014.

Nautilus has agreed to pay a finder's fee of US\$1 million in cash to arm's length parties relating to the placement.

As a result of the financing, the Board of Nautilus formally sanctioned the development of Solwara 1, following the closing of the private placement in full.

### **Project Development update**

Progress has continued with the Solwara 1 Project Development through Q3 2011.

Soil Machine Dynamics continues to progress the development of the Seafloor Production Tools ("SPTs"). Detailed design has advanced and procurement of key component sub assemblies continues. Factory acceptance tests have been completed for subsea motors with further (under load) testing due to be complete by year end. Variable speed drives have been delivered to SMD. Factory acceptance testing on the Bulk Cutter boom assembly (including cutter drum and gearboxes) will occur early in the fourth quarter and will then be delivered to SMD along with the previously completed Auxilliary Cutter heads and gearboxes. Following successful prototype testing of the umbilical, manufacturing is due to commence in Q4 2011. SMD are now in receipt of track simulation data from Caterpillar and are progressing track/chassis interface detail. The Collection Machine boom and yoke fabrication has been let.

Technip USA is progressing with development of the Riser and Lift System. Bid packages for most of the riser subcomponents have been issued to market. Orders are now placed for the riser package and the subsea connectors. Engineering continues for the surface pump systems and for the main SSLP. Full scale loop testing of the subsea pump and control valves is continuing. Work is underway to appoint the riser system engineering verification body.

The strategic alliance with Harren & Partner ("H&P") was formalised in a Heads of Agreement in the 2<sup>nd</sup> quarter and the associated detailed agreements are now being prepared for execution. H&P continue to finalise the funding arrangements. Model tank testing has been completed for resistance/speed trials and dynamic positioning system capability simulations are underway. The shipyard has now commenced engineering of long lead components and issued enquiry packages for engines and electrical systems.

Work continues on the development of the detailed plan to integrate the mining equipment onto the vessel. The pre-qualification exercise to select the vessel integration yard has commenced.

Detailed engineering and long lead item tender packages have been issued in relation to the dewatering system with first responses expected during Q4 2010.

## Exploration and Drilling Update

In May, Nautilus completed its 2010/11 seafloor drilling program, with the vessel, REM Etive, having demobilized in Singapore on May 16, 2011.

During the drilling program in the Bismarck Sea, Nautilus completed a 99 hole diamond drilling project, for a total of 1,475 metres.

Drilling was focused within the area of the Mining Lease ("ML154") recently granted to Nautilus, which contains the Solwara 1 deposit and the Solwara 5 seafloor massive sulphide (SMS) discovery. A total of 71 holes were drilled in ML154, for 1,147 metres. The remainder of the drilling was conducted in Exploration Lease 1374, which hosts Nautilus' Solwara 12 SMS discovery.

The highlight of the campaign was the identification of mineralization at depth at Solwara 12 and the improved knowledge gained at Solwara 1.

The company continues to evaluate the drill data gathered in the campaign. All QA/QC was completed and 3D geological modelling has commenced. Golder and Associates remain on track to complete the resource estimate before the end of the year.

### **\$155.1 Million (equivalent) in Cash and Cash Equivalents**

Nautilus is in a strong financial position with \$155.1 million (equivalent) in cash and cash equivalents held on deposit with banks holding an S&P rating of A+ or better, as at September 30, 2011. A further C\$27.6 million was received on October 6, 2011 following the closing of the second tranche of the private placement.

## **RISK FACTORS**

Nautilus' ability to generate revenues and achieve a return on shareholders' investment must be considered in light of the early stage nature of the Solwara 1 deposit and seafloor resource production in general. The Company is subject to many of the risks common to early stage enterprises, including personnel limitations, financial risks, metals prices, permitting, the need to raise capital, resource shortages and lack of revenues. Factors that influence the Company's ability to succeed are more fully described in the Company's 2010 Annual Information Form available on [www.sedar.com](http://www.sedar.com) under the heading "Risk Factors".

## **SUMMARY OF QUARTERLY RESULTS (unaudited)**

The following table sets out selected unaudited quarterly financial information of Nautilus and is derived from unaudited quarterly consolidated financial statements prepared by management and are expressed in US dollars.

		2009 Cdn GAAP	2010 IFRS				2011 IFRS		
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Revenue	\$'M	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Loss for the period	\$'M	(14.4)	(7.5)	(11.3)	(3.7)	(0.5)	(3.1)	(4.8)	(11.4)
Basic and diluted loss per share	\$/share	(0.09)	(0.05)	(0.07)	(0.02)	(0.13)	(0.02)	(0.03)	(0.07)

## **RESULTS OF OPERATIONS**

The following discussion provides an analysis of the financial results of Nautilus:

### ***For the three months ended September 30, 2011***

#### ***Income for the period***

##### *Net income*

For the three months ended September 30, 2011, the Company recorded a loss of \$11.4 million (\$0.07 loss per share) compared to a loss of \$3.7 million (\$0.02 loss per share) for the same period in 2010.

##### *Exploration expense*

Exploration expense decreased to \$1.6 million (2010 - \$2.7 million) due to exploration costs associated with Solwara 1 being capitalised as Mineral Properties. During the same period in 2010 all exploration costs were expensed.

##### *General & Administration expense*

General & Administration expense increased to \$5.0 million (2010 - \$3.1 million) largely due to professional services expenses incurred in relation to financing opportunities investigated during the current period.

##### *Technology expense*

Technology expense increased to \$0.4 million (2010 - \$0.1 million) due to an increase in studies undertaken during the current period. In the prior period technology related expenses were focused on the development of Solwara 1 and were included in development expense.

##### *Development expense*

Development expense relates to the Solwara 1 project and has decreased to \$0.1 million (2010 - \$3.0 million) due to development expenses being capitalised following the grant of the mining lease for Solwara 1 (ML 154). Following the grant of ML 154 in January 2011, Management concluded that an economic benefit is more likely than not to be realized from Solwara 1 and therefore costs directly associated with the development of Solwara 1 are now being capitalised. Costs incurred in relation to the maintenance of land at Lassul Bay, PNG, the potential site for onshore treatment, continues to be expensed as incurred.

##### *Foreign exchange gains and losses*

A foreign exchange loss of \$4.5 million was recorded during the period (2010 – foreign exchange gain of \$5.0 million). The foreign exchange gain and loss consists of realised gains and losses on actual cash transactions during the period and unrealised gains and losses of cash denominated in different currencies at the period end. The Company holds a “basket of currencies” to act as a natural hedge against its expected cash outflows and can therefore experience unrealised fluctuations at period end when cash balances are converted to US dollars for reporting purposes.

##### *Interest income*

Interest income earned on cash and cash equivalents held during the period was \$0.1 million (2010 - \$0.3 million). The decrease was attributable to the decrease in average levels of cash held during the period. The Company maintains its cash and cash equivalents with banks with an S&P rating of A+ or better.

### *Operating Loss*

Overall, Nautilus' operating loss increased to \$11.7 million for the period ended September 30, 2011, up from \$4.1 million for the same period in 2010 due to a movement in unrealised foreign exchange losses of \$9.5 million from the previous period. When foreign exchange gains/losses are ignored, the overall operating loss has decreased to \$6.9 million from \$9.1 million from the previous period. Engineering work directly related to the purchase of equipment has been included as "assets under construction" and is detailed below under Investing activities.

### **For the nine months ended September 30, 2011**

#### ***Income for the period***

##### *Net income*

For the nine months ended September 30, 2011, the Company recorded a loss of \$19.4 million (\$0.12 loss per share) compared to a loss of \$22.5 million (\$0.14 loss per share) for the same period in 2010.

##### *Exploration expense*

Exploration expense decreased slightly to \$5.7 million (2010 - \$5.8 million).

##### *General & Administration expense*

General & Administration expense increased to \$10.9 million (2010 - \$9.6 million) due to an increase in office space to accommodate additional employees as the Solwara 1 project continues to move forward.

##### *Technology expense*

Technology expense increased to \$0.8 million (2010 - \$0.3 million) due to an increase in studies undertaken during the current period. In the prior period technology related expenses were focused on the development of Solwara 1 and were included in development expense.

##### *Development expense*

Development expense relates to the Solwara 1 project and has decreased to \$0.3 million (2010 - \$7.0 million) due to development expenses being capitalised following the grant of the mining lease for Solwara 1 (ML 154). Costs incurred in relation to the maintenance of land at Lassul Bay, PNG, the potential site for onshore treatment, continues to be expensed as incurred until a decision is made as to whether a treatment facility will be developed at the site.

##### *Foreign exchange gains and losses*

A foreign exchange loss of \$1.9 million was recorded during the period (2010 – foreign exchange loss of \$0.2 million). The foreign exchange gain and loss consists of realised gains and losses on actual cash transactions during the period and unrealised gains and losses of cash denominated in different currencies at the period end. The Company holds a "basket of currencies" to act as a natural hedge against its expected cash outflows and can therefore experience unrealised fluctuations at period end when cash balances are converted to US dollars for reporting purposes.

##### *Interest income*

Interest income earned on cash and cash equivalents held during the period was \$0.6 million (2010 - \$1.1 million). The decrease was attributable to the decrease in cash held during the period. The Company maintains its cash and cash equivalents with banks with an S&P rating of A+ or better.

### *Operating Loss*

Overall, Nautilus' operating loss decreased to \$20.2 million for the period ended September 30, 2011, down from \$23.6 million for the same period in 2010. When foreign exchange gains/losses are ignored, the overall operating loss has decreased to \$18.3 million from \$23.4 million from the

previous period. The decrease is due to development work directly associated with the Solwara 1 deposit being capitalised from January 2011 following the grant of ML154, offset in part by an increase in general and administration and technology costs. Engineering work directly related to the purchase of equipment has been included as “assets under construction” and is detailed below under Investing activities.

### **Cash flows**

#### *Operating activities*

Cash used in operating activities for the nine month period ended September 30, 2011 was \$24.4 million compared to \$25.0 million for the period ended September 30, 2010. The decrease in cash used in operating activities is attributable to exploration and development costs associated with the Solwara 1 project being capitalised as Mineral Properties and included in investing activities.

#### *Investing activities*

Cash used in investing activities for the nine month period ended September 30, 2011 was \$56.7 million as compared to \$5.3 million for the nine month period ended September 30, 2010. The increase is due to the capitalisation of mineral property costs related to exploration and development of the Solwara 1 project following the grant of ML 154 which totalled \$27.3 million and the payment of milestone payments in relation to the build of subsea production equipment which totalled \$31.2 million. In addition, the Company received an advance payment of \$1.8 million from Petromin relating to the acquisition of their 5% interest in the Vessel Joint Venture.

#### *Financing activities*

Cash from financing activities for the nine month period ended September 30, 2011 was \$72.9 million received in relation to the closing of the first tranche of the private placement and the exercise of stock options. There was no cash generated from financing activities during the nine months ended September 30, 2010.

## **LIQUIDITY AND CAPITAL RESOURCES**

The Company’s financial objective is to ensure that it has sufficient liquidity in the form of cash and/or debt capacity to finance its ongoing requirements to support the Company’s strategy of becoming the first company to commercially extract copper, gold, silver and zinc from the seafloor.

### **Key financial measures**

The Company uses the following key financial measures to assess its financial condition and liquidity:

	<b>September 30 2011</b>	<b>December 31 2010</b>
Current Ratio	27.5 to 1	11.8 to 1
Working Capital	\$151.1 million	\$151.1 million
Cash and Cash Equivalents	\$155.1 million	\$165.1 million

Under the Company’s Investment Policy, cash cannot be invested for more than 90 days and must be held on deposit with banks with an S&P credit rating of A+ or better.

### ***Outlook and capital requirements***

The Company's known contractual obligations at September 30, 2011, are quantified in the table below:

	<b>September 30 2011 \$</b>
<b><i>Non-cancellable operating leases</i></b>	
Not later than 1 year	1,074,156
Later than 1 year and not later than 2 years	983,126
Later than 2 years and not later than 3 years	983,126
Later than 3 years and not later than 4 years	741,388
Later than 4 years and not later than 5 years	16,175
	<hr/>
	3,797,970
	<hr/>
<b>Total Commitments</b>	<b>3,797,970</b>

The Company is involved in mineral exploration which is a high risk activity and relies on results from each exploration program to determine if areas justify any further exploration and the extent and method of appropriate exploration to be conducted.

The Company has budgeted to spend approximately \$30 million for exploration work in 2011 on the Solwara 1 Project and other regional exploration programs. If exploration results and engineering studies are positive, the Company may consider committing additional funds to finance further engineering and exploration studies. In addition, the Company may consider further increases in staffing levels.

In order to maintain the exploration leases, licenses and permits in which the Company is involved, the Company is expected to fulfill the minimum annual expenditure conditions under which the tenements are granted. These obligations may be varied from time to time, subject to approval, and are expected to be fulfilled in the normal course of operations of the Company. The exploration commitments are based on those exploration tenements that have been granted and may increase or decrease depending on whether additional applications are granted, relinquished or if the Company forms joint ventures in the future.

### ***Cancellable commitments***

The Company has entered into various contracts for the design and build of the seafloor production system. As at September 30, 2011, the remaining value of the contracts is US\$132.4 million (equivalent). The contracts are cancellable by the Company at any time; however, in the event of cancellation, the Company would be liable for any costs incurred up to that point in time. No other penalties or cancellation fees are payable under these contracts.

The Company will need to obtain significant additional capital to develop any of its exploration properties, including Solwara 1, and debt financing may not be obtainable for a project such as that contemplated. The Company may need to rely on the equity markets for future financing of the Company's development of Solwara 1 or alternate financing in the form of joint ventures, leasing options and offtake agreements which may not be obtainable for the project as contemplated.

Nautilus expects that on hand cash and cash equivalents will be sufficient to pay for the continued budgeted exploration, approved capital expenditure and general and administrative costs of the Solwara 1 Project for the next 12 months. Depending upon future events, the rate of expenditures and other general and administrative costs could increase or decrease. The Company continues to evaluate a range of alternative options available to it to access capital to fund future expenditures.

Nautilus' opinion concerning liquidity and its ability to avail itself in the future of the financing options mentioned in the above forward-looking statements are based on currently available information. To the extent that this information proves to be inaccurate, future availability of financing may be adversely affected. Factors that could affect the availability of financing include Nautilus' performance (as measured by various factors including the progress and results of its exploration work), the state of international debt and equity markets, investor perceptions and expectations of past and future performance, the global financial climate, metal and commodity prices, political events in the south Pacific, obtaining operating approvals from the PNG government for the Solwara 1 Project, drilling and metallurgical testing results, results from environmental studies, engineering studies and detailed design of equipment.

***Foreign currency exchange rate risk***

The Company's operations are located in several different countries, including Canada, Australia, PNG, Tonga, Solomon Islands, Fiji and New Zealand and require equipment to be purchased from several different countries. Nautilus has entered into key contracts in United States dollars, British Pounds sterling and Euros. Future profitability could be affected by fluctuations in foreign currencies. The Company has not entered into any foreign currency contracts or other derivatives to establish a foreign currency protection program but may consider such actions in the future.

Foreign exchange risk is mitigated by the Company maintaining its cash in a "basket" of currencies that reflect its current and expected cash outflows. As at September 30, 2011 the Company held its cash in the following currencies:

<b>Currency Denomination</b>	<b>% of total cash in US\$ terms held</b>
USD	27
GBP	18
AUD	4
EUR	4
CAD	47
	100

***Interest rate risk***

The Company holds cash and cash equivalents which earn interest at variable rates as determined by financial institutions.

As at September 30, 2011, with other variables unchanged, a 1% increase (decrease) in the interest rate would have changed our net loss by approximately \$1.2 million for the nine month period. There would be no significant effect on other comprehensive income.

***Credit risk***

The Company places its cash only with banks with an S&P credit rating of A+ or better.

Our maximum exposure to credit risk at the reporting date is the carrying value of cash and cash equivalents and other receivables.

### **Liquidity risk**

The Company manages liquidity by maintaining adequate cash and short-term investment balances. In addition, the Company regularly monitors and reviews both actual and forecasted cash flows.

The exposure of the Company to liquidity risk is considered to be minimal.

### **CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS**

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

In preparing these financial statements, the Company makes estimates and assumptions concerning the future. The resulting accounting estimates may differ from the actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

#### a) Stock based compensation

The estimated fair value of stock options is based on subjective assumptions that are input into an option pricing model. The assumptions include an estimate of the average future hold period of issued stock options before exercise; future volatility of the Company's share price in the expected hold period; historical forfeiture rate; dividend yield; and the appropriate risk-free rate of interest. The resulting fair value calculated is not necessarily the value that the holder of the options could receive in an arm's length transaction, because there is no market for the options.

#### b) Impairment Testing

Property, plant and equipment and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (called cash-generating units or "CGUs"). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

### **FUTURE ACCOUNTING PRONOUNCEMENTS**

#### *International Financial Reporting Standard 9, Financial Instruments ("IFRS")*

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The Company is yet to assess IFRS 9's full impact or whether it will adopt the standard early.

### ***IFRS 10, IFRS 11, IFRS 12, IAS 27 IFRS 13, IAS 19 and IAS 28***

In May 2011, the IASB issued the following standards which have not yet been adopted by the Company: IFRS 10, *Consolidated Financial Statements* (IFRS 10), IFRS 11, *Joint Arrangements* (IFRS 11), IFRS 12, *Disclosure of Interests in Other Entities* (IFRS 12), IAS 27, *Separate Financial Statements* (IAS 27), IFRS 13, *Fair Value measurement* (IFRS 13), IAS 19, *Employee Benefits* and amended IAS 28, *Investments in Associates and Joint Ventures* (IAS 28). Each of the new standards is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The Company has not yet begun the process of assessing the impact that the new and amended standards will have on its financial statements or whether to early adopt any of the new requirements.

The following is a brief summary of the new standards:

#### *International Financial Reporting Standard 10, Consolidation ("IFRS 10")*

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 Consolidation – Special Purpose Entities and parts of IAS 27 Consolidated and Separate Financial Statements.

#### *International Financial Reporting Standard 11, Joint Arrangements ("IFRS 11")*

IFRS 11 requires a venture to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venture will recognize its share of the assets, liabilities revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionally consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, Interests in Controlled Entities – Non-monetary Contributions by Venturers.

#### *International Financial Reporting Standard 12, Disclosure of Interests in Other Entities ("IFRS 12")*

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities.

#### *International Financial Reporting Standard 13, Fair Value Measurement ("IFRS 13")*

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement.

## **INTERNATIONAL FINANCIAL REPORTING STANDARDS (“IFRS”)**

In January 2006, the Canadian Accounting Standards Board (“AcSB”) adopted a strategic plan for the direction of accounting standards in Canada. In February 2008, the Canadian Institute of Chartered Accountants (the CICA”) announced that GAAP for publicly accountable enterprises would be replaced by IFRS for interim and annual financial statements for fiscal beginning on or after January 1, 2011. The standard also requires that comparative figures for 2010 be based on IFRS. The CICA announcement also stated that the IFRS to be used for financial statement purposes should be those in effect as at December 31, 2011 and therefore the Company’s financial reporting for the first three quarters of 2011 and any public disclosures prior to December 31, 2011 will be based on the Company’s expectations of IFRS as at the subsequent date of December 31, 2011. While it is not expected that IFRS will change significantly prior to December 31, 2011, there is no assurance that IFRS will not change.

The Third Quarter 2011 Financial Statements have been prepared by the Company under IFRS. Please refer to the First Quarter 2011 Financial Statements which contain significant disclosure regarding the impact of the transition to IFRS from Cdn GAAP. Please refer to the First Quarter 2011 Financial Statements for details of the accounting policies being used under IFRS as well as reconciliations of certain prior period Cdn GAAP financial statements to IFRS.

IFRS 1 First-time Adoption of International Financial Reporting Standards (“IFRS 1”) sets forth guidance for the initial adoption of IFRS. Under IFRS 1 the standards are applied retrospectively at the transitional balance sheet date with all adjustments to assets and liabilities taken to retained earnings unless certain exemptions are applied.

## **OUTSTANDING SHARE DATA**

The following is a summary of the Company’s outstanding share data as of November 11, 2011.

### ***Common shares***

A total of 195,775,741 common shares are outstanding including 200,000 restricted shares.

### ***Restricted shares***

The Company’s share loan plan (the “Loan Plan”) was approved by the Company’s shareholders at the Annual General Meeting in July 2011. The Loan Plan provides for security-based compensation in a manner similar to a stock option plan by enabling participants to acquire an equity interest in the Company using a limited recourse loan provided by a subsidiary of the Company.

The Loan Plan provides for loans to be made to eligible employees who will apply the proceeds toward a subscription for shares. The loans will be made by a subsidiary of the Company and the shares issued by Nautilus will be registered in the name of an administrative agent for the benefit of the applicable employee.

The loan will not bear interest, and the Lender’s recourse will be limited to the value of the shares. If the employee elects to sell the shares, the proceeds will be used to repay the loan and any brokerage and other fees, and the employee will be entitled to any remaining balance.

Employees can only elect to sell the shares if the then-current market price is greater than the subscription price paid for those shares, such that the net proceeds of the sale will equal or exceed the outstanding loan balance in respect the shares being sold. An employee may, during the term of the loan, elect to repay the loan and become the registered holder of the shares. If an employee ceases to be eligible to participate in the Loan Plan or if the term of the loan expires

before the loan is repaid, the administrative agent will return the shares to the Company, and both the loan and the shares will be cancelled.

Shares issued pursuant to the Loan Plan are referred to as "Restricted Shares" as long as they are outstanding and registered in the name of the agent.

The purpose of the Loan Plan is to provide a tax-efficient security-based compensation program for the Company's Australian employees and directors.

A total of 200,000 restricted shares are issued and outstanding under the Company's share loan plan, with a loan expiry date of September 2, 2013. The issue price for the restricted shares is C\$2.91.

### ***Convertible securities***

The Company now has 9,104,000 options outstanding.

#### *Stock Options*

A total of 9,104,000 stock options are issued and outstanding, with expiry dates ranging from November 26, 2011 through to September 2, 2014. The weighted average exercise price for all stock options is C\$2.49. All stock options entitle the holders to purchase common shares of the Company.

## **INTERNAL CONTROLS**

### ***Internal control over financial reporting***

The Company's management, with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of Nautilus' disclosure controls and procedures. Based on the results of that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as at September 30, 2011, the Company's disclosure controls and procedures were effective in providing reasonable assurance that the information required to be disclosed by the Company in reports it files are recorded, processed, summarized and reported within the appropriate time periods and forms.

The Company's management is responsible for establishing and maintaining adequate system of internal controls, including internal controls over financial reporting. Nautilus' internal controls include policies and procedures that (1) pertain to the maintenance of records that accurately and fairly reflect, in reasonable detail, the transactions related to acquisition, maintenance and disposition of assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS, and receipts are recorded and expenditures are incurred only in accordance with authorization of management and directors; and (3) provide reasonable (but not absolute) assurance of compliance with regulatory matters and to safeguard reliability of the financial reporting and its disclosures. Having assessed the effectiveness of the Company's internal controls over financial reporting, the Chief Executive Officer and Chief Financial Officer believe that: (1) the internal controls over financial reporting are effective and provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS; and (2) that no material failings in the reporting were discovered in the three months ended September 30, 2011.

There have been no material changes in the Company's internal control over financial reporting during the period ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

The Company's management, including the Chief Executive Officer and Chief Financial Officer, believe that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, but not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitation in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the control. The design of any system of control also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatement due to error or fraud may occur and not be detected.

#### **ADDITIONAL SOURCES OF INFORMATION**

Additional sources of information regarding Nautilus Minerals Inc. are on SEDAR at [www.sedar.com](http://www.sedar.com) and is on the Company's website [www.nautilusminerals.com](http://www.nautilusminerals.com).