

# **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 May 14, 2009 for the three months ended March 31, 2010. 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 audited consolidated financial statements for the year ended December 31, 2009. 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 that are based on the beliefs of its management as well as assumptions made by management and information currently available to the Company. When used in this document, the words "anticipate", "believe", "estimate", "expect" and similar expressions, as they relate to the Company or its management, are intended to identify forward-looking statements. Such forward-looking statements relate to, among other things, regulatory compliance, the sufficiency of current working capital, the estimated cost and availability of funding for the continued exploration of the Company's exploration properties. Such statements reflect the current views of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. Many factors could cause the actual results, performance or achievement of the Company to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements.

### **OUR BUSINESS**

#### **Overview**

Nautilus is the first company to commercially explore the ocean floor for copper, gold, silver and zinc seafloor massive sulphide ("SMS") deposits, and is well positioned to develop the world's first seafloor massive sulphide system. The Company's main focus for 2010 is the Solwara 1 Project which is located in the territorial waters of Papua New Guinea ("PNG") in the western Pacific Ocean. The proposed operations of the Company, subject to permitting and financing, will be the exploration for and the mining of SMS deposits for copper, zinc, gold and silver where there are economically viable discoveries.

#### **FIRST QUARTER 2009 HIGHLIGHTS**

- \$196.0 million (equivalent) in cash and cash equivalents held on deposit with major banks as at March 31, 2010
- MV Fugro Solstice demobilized in January 2010
- Solwara 1 project development update
- Exploration and drilling update

## **\$196.0 Million (equivalent) in Cash and Cash Equivalents Held on Deposit with Major Banks**

Nautilus is in a strong financial position with \$196.0 million (equivalent) in cash and cash equivalents held on deposit with banks holding an S&P rating of A+ or better, as at March 31, 2010.

### **Project Development update**

The Company made good progress with the development of the Solwara 1 project during the quarter. The grant of the Environmental Permit on December 29, 2009 was an important step in the approvals process and the Company continues to work with the PNG Government in relation to the grant of the Mining Lease.

During the quarter the Company reactivated the contract with Soil Machine Dynamics ("SMD") of Newcastle upon Tyne, UK for the design and build of the seafloor mining tools. The remaining value of the reactivated contract is US\$46.9 million (equivalent). The contract with SMD is cancellable by the Company at any time, however, in the event of cancellation the Company would be liable for any costs incurred by SMD up to that point in time. No other penalties or cancellation fees are payable under this contract.

The Company has not yet reactivated the Technip Riser and Lifting System ("RALS") Engineering, Procurement, Construction Management ("EPCM") contract nor the GE Oil & Gas supply contract for the subsea slurry lift pump. The full equipment build will not recommence until a strategic partner has been secured.

Work continued during the quarter on the selection of a vessel and the Company now has a short list of three potential vessels.

Recruitment of key project personnel is now underway to assist in the management of the SMD contract and to support project execution planning.

### **Exploration and drilling update**

The exploration vessel MV Fugro Solstice was successfully demobilised in Singapore on 12 January 2010 after completing a 132 day program of water geochemistry studies, geophysics, remotely operated vehicle ("ROV") mapping and ROV sampling. A total of 18 mineralised systems have now been defined within the Bismarck Sea, along with numerous zones of hot water venting, smaller chimney fields, and barite-rich zones.

Work continues in the evaluation of the exploration results from 2009. This activity focuses on the selection of appropriate discoveries for drilling later this year. In parallel the company is in the final stages of selection of a suitable deephole capable drilling unit and vessel to support the drilling activities.

## **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. The Company's interim consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and expressed in US dollars.

Period	Revenues (in millions)	Income (Loss) and Comprehensive Income (Loss) for the Period (in millions)	Basic Income (Loss) per Share	Diluted Income (Loss) per Share
1 <sup>st</sup> Quarter 2010	Nil	\$(8.0)	\$(0.05)	\$(0.05)
4 <sup>th</sup> Quarter 2009	Nil	\$(14.4)	\$(0.09)	\$(0.09)
3 <sup>rd</sup> Quarter 2009	Nil	\$(7.4)	\$(0.05)	\$(0.05)
2 <sup>nd</sup> Quarter 2009	Nil	\$2.7	\$0.02	\$0.02
1 <sup>st</sup> Quarter 2009	Nil	\$(8.0)	\$(0.05)	\$(0.05)
4 <sup>th</sup> Quarter 2008	Nil	\$(35.2)	\$(0.24)	\$(0.24)
3 <sup>rd</sup> Quarter 2008	Nil	\$(38.4)	\$(0.26)	\$(0.26)
2 <sup>nd</sup> Quarter 2008	Nil	\$(8.8)	\$(0.06)	\$(0.06)

## **RESULTS OF OPERATIONS**

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

### ***For the three months ended March 31, 2010***

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

##### *Net income*

For the three months ended March 31, 2010, the Company recorded a loss of \$8.0 million (\$0.05 loss per share) which is equal to the loss for the same period in 2009.

##### *Exploration expense*

Exploration expense increased to \$2.1 million (2009 - \$1.6 million) due to an increase in the number of exploration personnel compared to the same period in 2009.

##### *Interest income*

Interest income earned on cash and cash equivalents held during the period was \$0.5 million (2009 - \$0.6 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.

##### *Non-cash stock based compensation*

A total of \$1.1 million in non-cash stock based compensation was expensed during the period (2009 - \$1.0 million). The increase is attributable to the increase in the number of options outstanding over the period.

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

A foreign exchange loss of \$2.4 million was recorded during the period (2008 –loss of \$4.0 million). The foreign exchange loss consists of realised and unrealised gains and losses on actual cash transactions during the period and revaluations of cash denominated in different currencies at the period end.

#### *Depreciation expense*

Depreciation expense decreased slightly to \$0.2 million (2009 - \$0.3 million).

#### *Other general and administrative costs*

There has been an overall decrease in other general and administrative expenses compared to the same period in 2009 as the Company focuses its attention on planning for the exploration program scheduled for later in the year and continuing engineering studies.

Other general and administrative expenses consist of:

- management fees and salaries of \$0.4 million (2009 - \$0.3 million), an increase of \$0.1 million as a result of an increase in the size of the management team in 2009;
- wages and salaries of \$1.2 million (2009 - \$0.8 million), an increase of \$0.3 million due to an increase in the number of employees and general increase in salaries in keeping with market rates;
- office expenses increased to \$0.5 million (2009 - \$0.3 million), an increase of \$0.2 million in keeping with the increase in personnel;
- travel expenses of \$0.2 million (2009 - \$0.06 million), an increase of \$0.14 million over the period due to the timing of business travel taken during the quarter;
- professional fees of \$0.2 million (2009 - \$0.1 million), an increase of \$0.1 million over the period due to the timing of professional services provided; and
- listing and filing fees of \$0.1 million (2009 - \$0.1 million).

Overall, Nautilus' expenses decreased to \$8.4 million for the period ended March 31, 2010, down from \$8.6 million for the same period in 2009 due to a decrease in foreign exchange losses of \$1.6 million offset in part by an increase in exploration costs and salary and wages. 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 three month period ended March 31, 2010 was \$10.4 million as compared to cash flows used in operating activities of \$11.3 million for the period ended March 31, 2009. The decrease in cash used in operating activities is attributable to the lower accounts payable and accrued liabilities paid during the period.

#### *Investing activities*

Cash used in investing activities for the three month period ended March 31, 2010 was \$0.6 million as compared to \$0.5 million for the three month period ended March 31, 2009. This related to the purchase of equipment.

#### *Financing activities*

Cash from financing activities for the three month period ended March 31, 2010 and March 31, 2009 was \$Nil respectively.

## **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>March 31 2010</b>	<b>December 31 2009</b>
Debt to Equity	Nil	Nil
Current Ratio	107.6 to 1	25.9 to 1
Working Capital	\$194.5 million	\$201.2 million
Cash and Cash Equivalents	\$196.0 million	\$209.3 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 March 31, 2010, are quantified in the table below:

	<b>March 31 2010 \$</b>
<b>Non-cancellable operating leases</b>	
Not later than 1 year	301,529
Later than 1 year and not later than 2 years	148,470
Later than 2 years and not later than 3 years	30,228
Later than 3 years and not later than 4 years	-
	<u>480,227</u>
<b>Non-cancellable development agreements</b>	
Not later than 1 year	598,028
	<u>598,028</u>
 Total Commitments	 <u>1,078,255</u>

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 2010 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 whether the Company forms joint ventures in the future.

On December 17, 2008 the Company announced it had decided to adopt a more cautious strategy and to preserve its cash position by delaying the construction of the equipment for the Solwara 1 mining system. As a result all contracts relating to the Solwara 1 mining system have been terminated or suspended, depending on their criticality to the revised development program. All of the supplier agreements contained provisions for termination without penalty.

The contracts that have been suspended will not incur any additional costs, unless instructed by the Company to continue with engineering studies, until those contracts are reactivated. The remaining value of the suspended contracts is US\$49.0 million. The suspended contracts also contain provisions allowing the Company to cancel at any time.

All settlement amounts in relation to the terminated contracts have been finalised.

During the quarter the Company reactivated the contract with Soil Machine Dynamics ("SMD") of Newcastle upon Tyne, UK for the design and build of the seafloor mining tools. The remaining value of the reactivated contract is US\$46.9 million (equivalent). The contract with SMD is cancellable by the Company at any time, however, in the event of cancellation the Company would be liable for any costs incurred by SMD up to that point in time. No other penalties or cancellation fees are payable under this contract.

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 in the form of joint ventures, leasing options and offtake agreements which may not be obtainable for the project as contemplated.

Nautilus expects that the cash and cash equivalents will be sufficient to pay for the continued budgeted exploration, capital expenditure and general and administrative costs of the Solwara 1 Project and other Company expenditures for the next 12 months. Depending upon future events, the rate of expenditures and other general and administrative costs could increase or decrease. Other than as disclosed above, the Company has not formally sought to secure sources of additional financing 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 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 March 31, 2010 the Company held its cash in the following currencies:

<b>Currency Denomination</b>	<b>% of total cash in US\$ terms held</b>
USD	59
GBP	20
AUD	9
EUR	8
CAD	3
PGK	1
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	100
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### ***Interest rate risk***

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

For the period ending March 31, 2010, with other variables unchanged, a 1% increase (decrease) in the interest rate would have increased (decreased) our net earnings by approximately \$505,521. 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 POLICIES**

The details of the Company's accounting policies are presented in Note 2 of the audited consolidated financial statements for the year ended December 31, 2009. The following policies are considered by management to be essential to understanding the processes and reasoning that go into the preparation of the Company's financial statements and the uncertainties that could have a bearing on its financial results:

### ***Resource properties***

Acquisition and exploration costs are expensed as incurred since the Company is in the process of exploring its mineral tenements and has not yet determined whether these properties contain ore reserves that are economically recoverable. If and when the Company's management determines that economically extractable resource have been established, the subsequent costs incurred to develop such property, including costs to further delineate the ore body will be capitalised.

### **Future Accounting Pronouncements**

#### **Sections 1582, Business Combinations, 1601 Consolidated Financial Statements and 1602 Non-controlling interests**

Sections 1582, Business Combinations, 1601 Consolidated Financial Statements and 1602 Non-controlling interests will replace the former Sections 1581 Business Combinations, 1600 Consolidated Financial Statements and establish a new section for accounting for a non-controlling interest in a subsidiary. Section 1582 is effective for business combinations for which the acquisition date is on or after January 1, 2011 and Sections 1601 and 1602 apply to consolidated financial statements relating to years beginning on or after January 1, 2011.

### **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, as part of its strategic plan, AcSB confirmed that Canadian publicly accountable entities will be required to report under International Financial Reporting Standards ("IFRS"), which will replace Canadian GAAP for years beginning on or after January 1, 2011. Financial reporting under IFRS differs from Canadian GAAP in a number of respects, some of which are significant. IFRS on the date of adoption is also expected to differ from current IFRS due to new IFRS standards and pronouncements that are expected to be issued before the changeover date. We plan to prepare our financial statements in accordance with IFRS for periods commencing as of January 1, 2011.

The following information is presented pursuant to the October 2008 recommendations of the Canadian Performance Reporting Board relating to pre-2011 communications about IFRS conversion and to comply with Canadian Securities Administrators Staff Notice 52-320, Disclosure of Expected Changes in Accounting Policies Relating to Changeover to International Financial Reporting Standards. This information is provided to allow investors and others to obtain a better understanding of our IFRS changeover plan and the resulting possible effect on our financial statements. Readers are cautioned, however, that it may not be appropriate to use such information for any other purposes. This information also reflects our most recent assumptions and expectations; circumstances may arise, such as changes in IFRS, regulations or economic conditions, which could change these assumptions or expectations.

## ***IFRS Changeover Plan***

We have developed a plan for our changeover to IFRS comprised of three related phases:

- Review and Assessment
- Design
- Implementation

### ***Phase 1: Review and Assessment Phase***

The objective of this phase is to identify the required changes to our accounting policies and practices resulting from the changeover to IFRS to determine the scope of the work effort required for the Design and Implementation phases.

Phase 1 involves:

- A detailed review of all relevant IFRS standards to identify differences with our current accounting policies and practices
- The separate consideration of one-time accounting policy alternatives that must be addressed at the changeover date, and those accounting policy choices that will be applied on an ongoing basis in periods subsequent to the changeover to IFRS
- The prioritization of those differences that could have a more than inconsequential impact on our financial statements, business processes or IT systems
- The identification of internal stakeholders and business areas that may be affected by the changeover.

### ***Phase 2: Design Phase***

Phase 2 will result in the design and development of detailed solutions to address the differences identified in the first phase of our changeover plan. These solutions will result in certain necessary changes to our internal business processes and financial systems to comply with IFRS accounting and disclosure requirements.

Phase 2 activities include:

- The evaluation of accounting policy alternatives
- The investigation, development and documentation of solutions to resolve differences identified in Phase 1, reflecting changes to existing accounting policies and practices, business processes, IT systems and internal controls
- The implementation of a change management strategy to address the information and training needs of internal and external stakeholders

### ***Phase 3: Implementation Phase***

In the third and final phase of our changeover plan, we will implement the changes to affected accounting policies and practices, business processes, systems and internal controls. These changes will be tested prior to the formal reporting requirements under IFRS to ensure all significant differences are appropriately addressed in time for the changeover.

## ***Progress towards Completion of our IFRS Changeover Plan***

We have completed Phase 1 and 2 of our changeover plan to identify the differences between Canadian GAAP and IFRS that impact our financial statements. Our analysis to date as determined that our accounting policies are largely aligned with IFRS requirements in many key areas.

Appropriate resources have been identified to complete the changeover in a timely manner according to our plan milestones. We have also ensured training needs are met and will continue to be addressed throughout the changeover period.

At this time the impact that the future adoption of IFRS will have on our financial position and results of operations is not reasonably determinable or estimatable, however, such impact may be material. Additional information will be provided as we move towards the changeover date.

## **OUTSTANDING SHARE DATA**

The following is a summary of the Company's outstanding share data as of May 14, 2009.

### ***Common shares***

A total of 155,558,884 common shares are outstanding.

### ***Convertible securities***

The Company now has 13,258,500 options outstanding.

#### *Stock Options*

A total of 13,258,500 stock options are issued and outstanding, with expiry dates ranging from May 28, 2010 through to June 30, 2013. The weighted average exercise price for all stock options is C\$2.95. All stock options entitle the holders to purchase common shares of the Company.

## **INTERNAL CONTROLS**

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

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. Any system of internal control over financial reporting, no matter how well designed, has inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

There have been no changes in the Company's internal control over financial reporting during the period ended March 31, 2010 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

## **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).