

**Form 51-102F1**  
**Interim Management Discussion and Analysis<sup>1</sup>**  
**For**  
**Stornoway Diamond Corporation**  
**(“Stornoway” or the “Company”)**

**Containing Information up to and including December 10, 2009**

**OVERALL PERFORMANCE**

Stornoway has a well diversified and highly prospective diamond property portfolio, focused in Canada, that includes Renard, a development track diamond project with the potential to become Quebec’s first diamond mine, three advanced projects in eastern Nunavut at the minibulk sampling stage and several early stage grass roots projects throughout Canada in geologically prospective, underexplored regions. Stornoway’s strategy is to capitalize on near-term, small to medium sized diamond mining opportunities to build a growth oriented company that succeeds in the practical business of mining and selling rough diamonds, while at the same time, remains exposed to significant upside through exploration. Although the rough diamond market has been affected by the deepening global economic crisis, in taking a longer-term view, the rough diamond market is expected to strengthen in the face of tightening supply and Stornoway is well positioned to add diamond resources from existing projects and further acquisitions as new opportunities are identified. In addition, the Company has a management team with experience at each stage of the diamond pipeline, from exploration through development and marketing.

As of December 10, 2009, the Company holds interests, directly or through joint ventures, in approximately 20 separate project areas in Alberta, Ontario, Québec, Nunavut and the Northwest Territories covering more than 4 million acres. This property portfolio can be roughly subdivided into 168,000 acres of ‘development’ stage projects (the Foxtrot Property), 1.75 million acres of ‘advanced’ exploration properties (Aviat, Churchill, Qilalugaq and Timiskaming) and 2.1 million acres of ‘early stage’ projects (Blackstone, Itza and others) that collectively contain some 170 kimberlite bodies.

**Forward-Looking Statements**

This document may contain "forward-looking statements" within the meaning of Canadian securities legislation and the United States Private Securities Litigation Reform Act of 1995. These forward-looking statements are made as of the date of this document and the Company 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 management's expectations or beliefs regarding future events and include, but are not limited to, statements with respect to the estimation of mineral reserves and resources, the realization of mineral reserve estimates, the timing and amount of estimated future production, costs of production, capital expenditures, success of mining operations, environmental risks, unanticipated reclamation expenses, title disputes or claims and limitations on insurance coverage.

These forward-looking statements include, among others, statements with respect to Stornoway's objectives for the ensuing year, our medium and long-term goals, and strategies to achieve those objectives and goals, as well as statements with respect to our beliefs, plans, objectives, expectations, anticipations, estimates and intentions. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," and words and expressions of similar import are intended to identify forward-looking statements. In particular, statements regarding Stornoway's future operations, future exploration and development activities or other development plans contain forward-looking statements.

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<sup>1</sup> Note to Reader

The following management discussion and analysis of the Company’s financial condition and results of operations should be read in conjunction with the audited consolidated financial statements for the years ended April 30, 2009 and 2008 together with the notes thereto and the unaudited, interim consolidated financial statements for the six months ended October 31, 2009 and 2008. These financial statements have been prepared in Canadian funds in accordance with Canadian generally accepted accounting principles.

All forward-looking statements and information are based on Stornoway's current beliefs as well as assumptions made by and information currently available to Stornoway concerning anticipated financial performance, business prospects, strategies, regulatory developments, development plans, exploration, development and mining activities and commitments. Although management considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution readers not to place undue reliance on these statements as a number of important factors could cause the actual results to differ materially from the beliefs, plans, objectives, expectations, anticipations, estimates and intentions expressed in such forward-looking statements.

These factors include, but are not limited to, developments in world diamond markets, changes in diamond valuations, risks relating to fluctuations in the Canadian dollar and other currencies relative to the US dollar, changes in exploration, development or mining plans due to exploration results and changing budget priorities of Stornoway or its joint venture partners, changes in project parameters as plans continue to be refined; possible variations in ore reserves, grade or recovery rates; accidents, labour disputes and other risks of the mining industry; delays in obtaining governmental approvals or financing or in the completion of development or construction activities, the effects of competition in the markets in which Stornoway operates, the impact of changes in the laws and regulations regulating mining exploration and development, judicial or regulatory judgments and legal proceedings, operational and infrastructure risks and the additional risks described in Stornoway's most recently filed Annual Information Form, 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. When relying on our forward-looking statements to make decisions with respect to Stornoway, investors and others should carefully consider the foregoing factors and other uncertainties and potential events. Stornoway does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by Stornoway or on our behalf, except as required by law.

#### **Highlights for the six months ended October 31, 2009 and the period ended December 10, 2009:**

During the six months ended October 31, 2009 and the period ended December 10, 2009, the Company's primary focus was the completion of a revised National Instrument ("NI") 43-101 compliant mineral resource estimate for the Renard Diamond Project in North Central Québec. Highlights of this work, announced December 8, 2009, include:

- A total Indicated Mineral Resource of *23.0 million carats*, and a total Inferred Mineral Resource of *13.3 million carats*, increases of *228%* and *195%* respectively over the previous estimates published in December 2008.
- An Indicated Mineral Resource at Renard 2 of *18.0 million carats* and an Inferred Mineral Resource of *6.4 million carats*, increases of *557%* and *313%* over the previous estimates.
- An Indicated Mineral Resource grade at Renard 2 of *103 carats per hundred tonnes ("cpht")* and an Inferred Mineral Resource grade of *120 cpht*, increases of *27%* and *39%* over the previous estimates.
- A diamond valuation of *US\$117 per carat* to be applied equally to each of the Renard 2, 3, 4 and 9 kimberlite pipes for resource estimation purposes.
- New geological models demonstrating extensive upside in multiple kimberlite bodies.

## RESULTS OF OPERATIONS

The Company's loss from operations for the six months ended October 31, 2009 (the "Current Period") was \$5,954,000 (a loss of \$0.02 per share) as compared to a net income of \$10.5 million (earnings of \$0.05 per share) for the six months ended October 31, 2008 (the "Comparative Period"). The Company's loss for the Current Period is mainly due to a write-off of capitalized resource property costs (Current Period - \$6.3 million; Comparative Period \$321,000) and administrative expenses of \$1.3 million (Comparative Period - \$1.7 million). In the Comparative Period, the Company recorded a \$13.3 million gain on the early extinguishment of the debt component of a \$20.0 million convertible debenture.

Administrative expenses (Current Period - \$1.3 million; Comparative Period - \$1.7 million) decreased as the Company reduced its in-house laboratory employees in June 2008, reduced its office space in early 2009 and in general, sought ways to reduce administrative and overhead expenditures in the face of challenging economic conditions. The decrease in professional fees (Current Period - \$94,000; Comparative Period - \$170,000) and regulatory and shareholder communications expense (Current Period - \$157,000; Comparative Period - \$234,000) reflects a lower activity level and reduced budgets for the Company in the Current Period as compared to the six months ended October 31, 2008. Salaries and benefits (Current Period - \$260,000; Comparative Period - \$705,000) increased from the Comparative Period, after adjusting for a \$495,000 payment for severance in the Comparative Period. Some administrative expenditures increased in the Current Period, including: administrative fees and rent (Current Period - \$214,000; Comparative Period - \$160,000), office and sundry (Current Period - \$245,000; Comparative Period - \$195,000) and stock-based compensation (Current Period - \$300,000; Comparative Period - \$267,000), a non-cash item. Historically, a portion of the rent and office expense was allocated to the lab department. Expenses previously allocated to the lab department are now included with general and administrative expenses, after the lab department was restructured in June 2008. Consequently, rent and office expense increased as compared to the same period last year. General and administrative expenses include stock-based compensation, a non-cash item. Historically, the Company's stock options have vested in thirds over a one year period from the grant date, with the first third vesting immediately, the second third vesting six months from the grant date and the final third vesting one year from the grant date. In the Current Period, the Board of Directors adopted a Stock Option Grant Policy (the "Policy"). This Policy sets annual stock option grants and 5-year option level targets for all optionees, based on responsibility levels. Stock options vest immediately on the grant date, which resulted in an increase in stock-based compensation expense in the Current Period.

The Company's interest income declined in the Current Period to \$24,000 from \$139,000 in the Comparative Period, due to smaller cash balances available for investment and historically low interest rates paid on funds invested. Interest expense in the Current Period of \$40,000 (Comparative Period - \$Nil) includes an accrual for Part 12.6 tax related to the 2008 flow-through financing. In the Comparative Period, the Company wrote-down its investments by \$965,000 (Current Period - \$nil) as at the time of the impairment charge, the decline in fair value was deemed to be other than temporary. During the Current Period, the Company recorded a future income tax recovery of \$1.6 million (Comparative Period - \$93,000), which decreased the Company's net loss after taxes to \$6.0 million (Comparative Period - \$10.5 million net income).

As at October 31, 2009, total assets decreased to \$175.1 million from \$180.5 million at the April 30, 2009 year-end. Capitalized resource property costs decreased from \$171.2 million to \$168.1 million as at October 31, 2009. During the Current Period, the Company wrote-off capitalized resource property costs of \$6.3 million (Comparative Period - \$321,000). The majority of this write-off (\$6,023,000) relates to grass-roots exploration properties in Nunavut (\$5,330,000) and Eastern Canada (\$693,000) where limited exploration work has been conducted recently and where there are no future exploration plans for the foreseeable future. Also during the Current Period, the Company wrote-off \$286,000 related to generative exploration and other, non-material property interests. Write-offs in the Comparative Period totalled \$321,000 for non-material property interests in Canada where no future exploration was warranted or where the Company no longer retained a property interest.

The Company capitalizes all acquisition and exploration costs until the property to which those costs related is placed into production, sold or abandoned. The decision to abandon a property is largely determined from exploration results, exploration priorities and financial considerations. The amount and timing of the Company's write-offs of capitalized resource property costs will vary in a fiscal period from one quarter to the next and typically cannot be predicted in advance.

The Company's cash, cash equivalents and short-term deposit amounts decreased during the Current Period, from \$2.9 million as of April 30, 2009 to \$1.9 million as of October 31, 2009. The change in the Company's cash position resulted from a flow-through private placement, for gross proceeds of \$1.4 million, which closed on May 29, 2009 and the Company's expenditures of \$2.4 million for work related to the advancement of its resource expansion and optimization program at the Renard Diamond Project in Quebec.

The Company's Current Period's loss of \$6.0 million was greater than its net income of \$10.5 million in the Comparative Period due mostly to a \$13.3 million gain (net) on the early extinguishment of the Company's convertible debentures during the Comparative Period. In accordance with EIC-96 "Accounting for the early extinguishment of convertible securities through early redemption or repurchase", the Company recognized a gain, for accounting purposes, of \$13.9 million with respect to the liability component of the convertible debentures, which was settled with common shares using a deemed price of \$0.90 per share. At the date of the redemption, the Company's common shares traded at approximately \$0.30, resulting in a gain of \$13.9 million in the Comparative Period. As part of this redemption, the Company issued 2,222,222 common shares at a deemed value of \$0.90 to the holders. These common shares had a fair market value of \$667,000 (\$0.30 per share), which reduced the \$13.9 million gain on the early extinguishment of convertible debt to \$13.3 million in the Comparative Period.

## EXPLORATION UPDATE

Stornoway's material mineral properties are (i) the Foxtrot Property in the Otish Mountains located in Québec, Canada; and (ii) the Aviat One Property on the Melville Peninsula located in Nunavut, Canada. The following discussion is an update to disclosure in documentation filed with regulatory agencies and available for viewing under Stornoway's profile on the SEDAR website at [www.sedar.com](http://www.sedar.com).

### *Foxtrot Property – Renard Kimberlitic Bodies, Quebec*

The Foxtrot Property, containing the Renard cluster of kimberlite bodies, is a 50/50 joint venture between Stornoway's wholly owned subsidiary Les Diamants Stornoway (Canada) inc. ("Les Diamants Stornoway"), and SOQUEM Inc.'s ("SOQUEM") wholly owned subsidiary, Diaquem. Les Diamants Stornoway is the project operator. Since 1996, Les Diamants Stornoway and SOQUEM have evaluated an area of more than 400,000 square kilometres of the eastern Archean Superior craton. Exploration conducted by the joint venture has resulted in the discovery of a new field of kimberlitic intrusions on the Foxtrot property, notably the Renard cluster of kimberlitic bodies, and a nearby system of kimberlitic dykes, the Lynx-Hibou dykes.

On December 8, 2009, the Company completed and announced a revised National Instrument ("NI") 43-101 compliant mineral resource estimate for the Renard Diamond Project.

The new estimate, prepared by Mr. D. Farrow, P.Geol. (BC) of Golder Associates Ltd. ("Golder") an independent consultancy, follows the completion of a very successful 16,506 meter drill campaign at Renard during 2009, and draws upon revised geological models for each kimberlite body, a different grade estimation technique, and an updated diamond valuation by WWW International Diamond Consultants Ltd. Highlights are as follows:

- A total Indicated Mineral Resource of **23.0 million carats**, and a total Inferred Mineral Resource of **13.3 million carats**, increases of **228%** and **195%** respectively over the previous estimates published in December 2008.
- An Indicated Mineral Resource at Renard 2 of **18.0 million carats** and an Inferred Mineral Resource of **6.4 million carats**, increases of **557%** and **313%** over the previous estimates.
- An Indicated Mineral Resource grade at Renard 2 of **103 carats per hundred tonnes ("cpht")** and an Inferred Mineral Resource grade of **120 cpht**, increases of **27%** and **39%** over the previous estimates.
- A diamond valuation of **US\$117 per carat** to be applied equally to each of the Renard 2, 3, 4 and 9 kimberlite pipes for resource estimation purposes.
- New geological models demonstrating extensive upside in multiple kimberlite bodies.

In management's view, the Renard Project has three essential components: a large, high grade core resource within the Renard 2 & 3 kimberlites; a large, lower grade resource in the Renard 4 & 9 kimberlites offering mine expansion potential, and; extensive exploration upside. The new resource estimate marks the culmination of a highly successful year at Renard which has significantly increased the Company's understanding of the deposit model and the scope of the project. The Renard Project is located in Québec, Canada, the world's best mining jurisdiction, and is at the center of planned near-term infrastructure development. The latest resource work has increased the contained value of the resource significantly, with good potential to add additional resources thereafter. This pivotal study has now become the focus of an updated economic assessment, which the Company expects to complete in the 1<sup>st</sup> quarter of 2010, followed by an aggressive work program aimed at completing a final feasibility study as soon as possible.

### Mineral Resource Estimate (December 2009)

The NI 43-101 compliant estimate of Indicated and Inferred Mineral Resources, summarized in Table 1, was compiled by Golder. Golder reviewed updated three dimensional geological models for each kimberlite body (prepared by Stornoway) and extensive project data collected since 2001. The mineral resource estimate comprises the integration of kimberlite volumes, density, petrology and diamond content data obtained from 81,894 meters of diamond drilling, 6,151 meters of reverse circulation ("RC") drilling, 12.7 tonnes of samples submitted for microdiamond analysis, 600.8 carats of diamonds (6,457 stones) recovered from RC drilling and 8,611.6 carats of diamonds (84,381 stones) recovered from surface trenching and bulk sampling.

**Table 1: Total NI 43-101 Mineral Resource Estimate<sup>1,2,3</sup>**

Kimberlite	Grade (cpht) <sup>4,5</sup>	Tonnes (millions)	Contained Carats (millions)
<b>Indicated Resource</b>			
Renard 2	103	17.48	17.96
Renard 3	106	1.71	1.81
Renard 4	44	7.32	3.20
Renard 9	--	--	--
Lynx	--	--	--
Hibou	--	--	--
<b>Total Indicated</b>	<b>87 (+4.4%)</b>	<b>26.50 (+128%)</b>	<b>22.96 (+228%)</b>
<b>Inferred Resource</b>			
Renard 2	120	5.36	6.42
Renard 3	122	0.15	0.19
Renard 4	41	4.57	1.87
Renard 9	46	5.75	2.63
Lynx	107	1.80	1.92
Hibou	144	0.18	0.26
<b>Total Inferred</b>	<b>75 (+19%)</b>	<b>17.81 (+149%)</b>	<b>13.29 (+195%)</b>

<sup>1</sup>Resource categories are compliant with the "CIM Definition Standards on Mineral Resources and Reserves". Mineral resources that are not mineral reserves do not have demonstrated economic viability.

<sup>2</sup>Changes from previously disclosed NI 43-101 Mineral Resource Estimate shown in italics.

<sup>3</sup>Totals may not add due to rounding.

<sup>4</sup>Carats per Hundred Tonnes.

<sup>5</sup>Estimated at a +1 DTC sieve size cut-off

The revised mineral resource estimate shown above demonstrates an increase in both tonnage and carats when compared to the mineral resource documented in an earlier NI 43-101 "Technical Report on the Preliminary Assessment of the Renard Project" (dated December 12, 2008, revised March 25, 2009). Providing resource assumptions and economic parameters remain the same as in the earlier 43-101 report, the mineral resources

reported in Table 1 have reasonable prospects for economic extraction. However, mineral resources that are not mineral reserves do not have demonstrated economic viability.

### Potential Mineral Deposit

In addition to the mineral resources, Golder reviewed the potential mineral deposit which totals 12.2 to 26.5 million carats (26.8 to 45.7 million tonnes at grades ranging from 23 to 168 cpht), as summarized in Table 2.

**Table 2: Estimate of Potential Mineral Deposit<sup>1,2</sup>**

<b>Kimberlite Body</b>	<b>Range of Grades (cpht)<sup>3,4</sup></b>	<b>Range of Tonnes (millions)</b>	<b>Range of Cont. Carats (millions)</b>
Renard 2	-- to --	-- to --	-- to --
Renard 3	107 to 168	0.1 to 0.2	0.1 to 0.3
Renard 4	38 to 79	5.1 to 8.2	1.9 to 6.5
Renard 9	45 to 50	3.1 to 7.2	1.4 to 3.6
Renard 65	23 to 33	12.6 to 24.0	2.9 to 7.9
Lynx	96 to 120	3.1 to 3.2	3.0 to 3.8
Hibou	104 to 151	2.7 to 2.9	2.9 to 4.3
<b>Total Potential Mineral Deposit</b>		<b>26.8 to 45.7</b>	<b>12.2 to 26.5</b>

<sup>1</sup>Potential mineral deposit does not constitute a mineral resource, and the reader is referred to the cautionary language contained within this release.

<sup>2</sup>Totals may not add due to rounding.

<sup>3</sup>Carats per Hundred Tonnes.

<sup>4</sup>Estimated at a +1 DTC sieve size cut-off

The potential mineral deposit for the Renard kimberlite pipes has been determined by projecting reasonable kimberlite volumes from the base of the inferred resource to a depth of 700m below surface. In the case of the Lynx and Hibou dykes, the potential mineral deposit was established on the basis of known drill intersections of kimberlite for which insufficient diamond sampling exists to adequately estimate a diamond resource grade. A large quantity of kimberlite contained within the Renard 65 body has also been designated as potential mineral deposit given the sensitivity to diamond price growth over the expected mine-life at Renard. The reader is cautioned that the potential quantity and grade of any potential mineral deposit is conceptual in nature, and it is uncertain if further exploration will result in the target being delineated as a mineral resource.

### Tonnages and Grades

For each kimberlite pipe, 5m by 5m by 5m block models were created for tonnage and grade estimation using solid body geological models for each pipe, as revised by Stornoway and Golder. Resource tonnages were derived by combining rock volumes from the block models with representative specific gravity measurements for each kimberlite lithology. All tonnages cited are for kimberlite lithologies only, and do not include cracked or brecciated country rock units.

Cut-off depths for the mineral resource categories were defined within each pipe based on density of drill control and the consistency of grade data within the geological models. Indicated Mineral Resources at Renard 2 encompass kimberlite from surface to a depth of 600m, and Inferred Mineral Resources extend vertically for another 100m. Indicated Mineral Resources for Renard 3 and 4 extend from surface to a vertical depth of 250m. Inferred Mineral Resources extend from 250m to 395m below surface for Renard 3, and from 250m to 380m below surface for Renard 4. Renard 9 does not have a large tonnage bulk sample, and consequently the Inferred Mineral Resource extends from surface to 380m below surface. Inferred Mineral Resources for the Lynx and Hibou dyke systems are restricted to the areal extent of modeled kimberlite within 100m of surface trenches.

Grades for the kimberlite pipes were estimated by first establishing a “dilution model” derived from drill core and underground data. Representative “undiluted” grade models were constructed for each kimberlite lithology using

diamond datasets obtained from caustic fusion and dense media separation (“DMS”) processes. These undiluted grade models were then mapped onto the dilution model for each pipe, with the resulting resource models comprising blocks with lithology, grade and dilution parameters. As part of quality control exercises, grade and tonnage estimates were cross-checked against drill data for each kimberlite and tested for consistency with bulk sample data.

For each kimberlite body, diamond resource grades are estimated on a +1 DTC sieve size cut-off. An allowance has been made for the non-recovery of small diamonds typical in a commercial diamond production plant, and to make diamond resource grades consistent with the diamond valuation models, which have been established on the same basis. Following this exercise, Golder is confident that the resource models for each kimberlite body are consistent with the accumulated geological and diamond sampling data to the best extent possible.

#### *Notable Changes to the Mineral Resource Estimate since December 2008*

The revised Indicated and Inferred Mineral Resource tonnages at Renard 2 (17.48 million tonnes and 5.36 million tonnes respectively) represent increases of 420% and 198% compared to the December 2008 estimate and reflect the extension of known kimberlite to depths of 700m below surface during the 2009 drill program (Stornoway Diamond press release dated October 6<sup>th</sup>, 2009). At 700m below surface, the Renard 2 kimberlite lithologies measure approximately 116 by 224 meters, have a surface area of 2.1 hectares, and remain open at depth.

Changes to resource tonnages for Renard 3, 4 and 9 result from the application of a revised modeling technique that better reflects pierce points established by drilling and conforms to current geological emplacement models. Modifications to the Renard 3 model take into account three deep drill holes completed during the 2009 program.

The revised Renard 2 geological model comprises two primary kimberlite lithologies, a Tuffisitic Kimberlite Breccia (kimb2a or “Blue” kimberlite) and a Coherent Kimberlite (kimb2b or “Brown” kimberlite). High grade Hypabyssal Kimberlite (kimb2c) occurs in both the Blue and Brown units. The Blue unit has higher average country rock dilution than the Brown, and its grade is lower. The Renard 2 Indicated Mineral Resource grade of 103 cpht is derived from a Blue-Brown ratio of 58% to 42% to 600m depth, whilst the Inferred Mineral Resource grade of 120 cpht is derived from a more favourable Blue-Brown ratio of 43% to 57% between 600m and 700m depth. This represents increases in Indicated and Inferred Mineral Resource grades for Renard 2 of 27% and 39% respectively over the previous estimates.

Using the grade estimation methodology described above, Indicated and Inferred Mineral Resource grades for Renard 3 have decreased 9% and increased 1% respectively (to 106 cpht and 122 cpht), Indicated and Inferred Mineral Resource grades for Renard 4 have increased 19% and 32% respectively (to 44 cpht and 41 cpht), and the Inferred Mineral Resource Grade for Renard 9 has increased 15% (to 46 cpht).

New geological models were constructed for the Lynx and Hibou dykes, and grades were determined primarily from bulk sample recoveries. Some 177,800 tonnes of kimberlite (256,000 carats) contained within the Hibou dyke and previously designated as potential mineral deposit have been elevated to the Inferred Mineral Resource category on the basis of the large tonnage trench sampling completed subsequent to December 2008 (Stornoway press release dated January 15<sup>th</sup>, 2009). Inferred tonnage at Lynx has increased by 35% to 1.8 million tonnes.

#### *Diamond Breakage*

As an additional quality control measure, Golder commissioned a detailed diamond breakage study on each Renard diamond sample utilized in the resource estimation process. This was conducted by Dr. Paddy Lawless, a leading authority on diamond breakage, between August and September 2009. The study determined that overall diamond breakage levels were high, and breakage was particularly severe in the RC samples, and in the bulk samples processed at the joint venture’s wholly owned 10 tonne per hour DMS plant located at the project site. Diamond breakage in exploration sized samples has implications for grade and value determinations, and can occur in DMS processing plants because of aggressive ore crushing, excessive re-circulation of concentrates, and inter-particle impacts. Diamond breakage in RC samples is commonly attributed to both processing and the extraction method itself. Dr. Lawless’ study determined potential grade losses of between 23% and 38% in the RC samples and

between 15% and 28% in the bulk samples. A modest amount of diamond breakage can be expected in any diamond processing plant, including a commercial scale plant, so no attempt has been made to adjust the mineral resource grades to account for this effect. However, it is Golder's view that if appropriate diamond value management practices are followed in the production plant, improvements in grade and value recovery above that assumed in the mineral resource statement are possible upon production start-up.

### *Diamond Valuation*

As part of the current resource work, the diamond size frequency distributions of all bodies were examined in detail with consideration given to the diamond breakage and plant recovery characteristics of each diamond sample. It is the opinion of Golder that the size frequency distributions of Renard 2, Renard 3, Renard 4 and Renard 9 are similar, and that it is appropriate to use a single size frequency distribution to determine value on the basis that there exists a similar diamond population within the four kimberlite pipes.

In conjunction with the updated resource work, WWW International Diamond Consultants Ltd. ("WWW") were commissioned to provide an updated diamond valuation of the Renard diamond bulk samples that had been previously valued in September 2007 and again in March 2008. The new diamond value models were obtained by applying WWW's September 2009 rough diamond price book to the existing valuation models established during the earlier exercises. WWW have recommended a modeled "Base Case" diamond price estimate for both the Renard 2 and Renard 3 valuation samples of US\$117 per carat (estimated at a +1 DTC sieve size cut-off), with a "High" modeled price estimate of US\$131 per carat and a "Low" modeled price estimate of US\$103 per carat. This is a 3% decrease compared to the previous diamond price model of \$121 per carat determined in March 2008 (Stornoway press release dated April 28th 2008).

Consistent with the approach recommended by Golder, this price of \$117 per carat will also be applied to Renard 4 and Renard 9.

The WWW recommended "Base Case" diamond price estimate for the Lynx valuation sample is US\$57 per carat, with a "High" modeled price estimate of US\$85 per carat and a "Low" modeled price estimate of US\$48 per carat, a 14% decrease compared to the previous estimate.

### **Next Steps**

Stornoway will publish a NI 43-101 compliant technical report on the new mineral resource statement at Renard within 45 days. Concurrently, a revised economic assessment of the Renard Diamond Project utilizing the new mineral resource statement is being prepared by Scott Wilson Roscoe Postle Associates. The existing conceptual mine plan contained within the preliminary economic assessment published in December 2008 contemplated combined open pit and sub-level, open stope underground mining to 600m depth over a 7 year mine life at a processing rate of 1.3 mtonnes/annum. Life of mine capital costs were C\$308 million (including a \$50 million contingency) with a blended operating cost of C\$50.35/tonne. The bulk of the new resources disclosed by the Company on December 8, 2009 lie within the scope of this conceptual mine plan, and their inclusion in the revised study is expected to have a material impact on the economic potential of the project. At the same time, Stornoway is investigating the merits of an expanded mine plan with a higher production rate facilitated by a shaft and a more traditional, block caving underground mining technique. An expanded mine plan, although increasing project capital cost, has the potential to enhance the economic return of the project further still. The revised economic assessment is expected within the first quarter of 2010.

### **Qualified Persons for the NI 43-101 Report**

Mr. David Farrow, P.Geol. (BC), and Ms. Darrell Farrow, PrSciNat, both of Golder Associates Ltd. are the independent Qualified Persons responsible for the preparation of the mineral resource estimate, excluding the diamond valuation, for the Renard Diamond Project. The Renard Diamond Project is managed by Dave Skelton, P. Geol. (AB/QC), Vice President, Project Development, and a Qualified Person under NI 43-101. All of these Qualified Persons reviewed and approved the contents of the December 8, 2009 news release, which has been incorporated into this interim MD&A.

### *Aviat Property, Nunavut*

The Company's interest in the 447,800 acre Aviat Property is governed by a joint venture agreement with Hunter Exploration Group ("Hunter"). This agreement was modified in May 2008 when the Company acquired BHP Billiton's ("BHPB") interest in the Aviat Project and BHPB's diamond marketing rights for the Aviat Project, in consideration for the Company assuming all of BHPB's obligations under the joint venture agreement, including BHPB's bulk sampling obligations and all future funding obligations. This acquisition increased the Company's interest in the Aviat Project to 90% (Hunter continues to hold a 10% interest, carried to production) and provided the Company with 100% of the diamond marketing rights for the Aviat Project.

The Company did not conduct a field exploration program at Aviat during 2009. The Company expects to conduct a market valuation exercise on the full parcel of diamonds recovered from the ES1 kimberlite sheet once the world rough diamond market, which is currently experiencing internal financial volatility, has stabilized such that pricing information suitable for long term, advanced level, exploration planning can be obtained. Although this valuation work, being based on a small parcel of diamonds, will provide only a preliminary sense of the average diamond price at Aviat, it will be sufficient, in conjunction with the October 2008 conceptual study, to provide a qualified estimate of value contained within the ESC. This estimate will in turn support subsequent desktop studies aimed at determining optimum mining scenarios for the ESC. The conclusions of these studies will dictate the nature and type of future sampling required to obtain a National Instrument ("NI") 43-101 compliant mineral resource statement at Aviat.

### *Churchill Property, Nunavut*

The Company initially acquired a partial interest in the diamond rights at the Churchill Property in June 2002. Currently, the Company's interest in the Churchill Diamond Project is approximately 38%, with the remaining 62% interest held by Shear Minerals Ltd. ("Shear"). Shear is the operator of the Project and is currently sole-funding exploration. Stornoway elected not to participate for its share of the 2008 exploration budget and to-date, Shear has not proposed a program for 2009. The Churchill Diamond Project currently encompasses approximately 760,000 acres situated on the mainland tundra (barren lands), near the community of Rankin Inlet in the Kivalliq Region of Nunavut, Canada.

In August 2009, Shear and the Company signed an indicative proposal with Kennecott Canada Exploration Inc. ("Kennecott") to jointly explore the northern portions of the Churchill Diamond Project. This area, to be referred to as the Chesterfield Inlet Diamond Project (the "Chesterfield Project"), comprises approximately 70,000 acres located within and near the indicator mineral dispersion North Corridor of the larger Churchill Diamond Project. The Chesterfield Project area is located approximately 15 km north of the Josephine River Corridor and portions can be accessed by gravel road from the community of Chesterfield Inlet. The focus of the new partnership will be the exploration of the northern regions of the property, starting with a comprehensive geophysical and geochemical review to be followed up by a modest field program during 2009.

Under the terms of the agreement, Shear and the Company have jointly granted Kennecott the right and option to acquire, subject to existing underlying royalties, up to a 70% interest in the diamond rights to the Chesterfield Project. Under the terms of the agreement, Kennecott may acquire a 51% interest in the Chesterfield Project (the "First Option") by incurring \$100,000 in exploration expenditures before Dec 31, 2010 and by incurring an additional \$1,900,000 in exploration expenditures before December 31, 2012. If the First Option is satisfied, Kennecott may earn an additional 19% interest (the "Second Option") in the Chesterfield Project by incurring an additional \$4,500,000 in exploration expenditures before December 31, 2016. Shear will be the Operator during the First Option.

### *Hammer Property*

In 2008, Stornoway and North Arrow Minerals Inc. ("North Arrow") revised the Bear Property joint venture agreement to include an area of interest (AOI) outside of the original Bear Property claims, known as the "Hammer AOI". A claim was staked in October of 2008 to cover a potential source area, adjoining one of the claims

remaining from the original Bear Property. Subsequently, a joint venture covering the AOI (the two claim 2,533 acre Hammer Property) was signed between Stornoway (75%) and North Arrow (25%), with Stornoway acting as the operator.

In July 2009, a new kimberlite was discovered by prospecting on a mineral claim within the Hammer AOI and at the head of a previously unexplained kimberlitic indicator mineral anomaly with diamond inclusion chemistry. The Hammer kimberlite appears associated with a prominent topographic feature that is 225m long, between 15 and 100m wide, and has a surface expression of approximately 1 hectare, although the true nature and size of the body is not known at this time. Weathered kimberlite breccia in bedrock was identified within hand dug pits, in addition to numerous scattered kimberlite occurrences of surface float and frost heaved kimberlite fragments. Previous analyses of till samples collected down-ice of the Hammer kimberlite have returned the full suite of traditional kimberlite indicator minerals, including both pyrope and eclogite garnets, and the mineral chemistry of these indicators is indicative of a potentially diamond bearing kimberlitic intrusive.

Samples of surface float and in-situ kimberlite were collected from the Hammer kimberlite, although permafrost conditions and equipment constraints prevented the collection of a large sample of fresh kimberlite for representative microdiamond analysis at this time. Stornoway and North Arrow are currently reviewing potential future work required to properly assess the Hammer discovery, which may include additional prospecting, kimberlite sampling for micro diamond recovery, ground geophysical surveys or drilling.

#### *Other Properties (Various Interests)*

Stornoway and its wholly owned subsidiaries hold varying interests in a number of other diamond properties and prospects, as well as significant regional geological, geochemical and geophysical databases. The Company's technical team reviews these properties and databases as time allows, in addition to other properties or information that may become available, so that the Company can continue to maintain a portfolio of promising diamond projects that fill the 'pipeline' from grassroots to development stage. Exploration activities, including drilling, will be undertaken where warranted and where permitted by logistical and budgetary considerations. Results will be reported as appropriate.

Results from the Company's previous generative exploration program have been, and will continue to be, used to identify and acquire targeted landholdings thought to have the potential to host diamondiferous kimberlites. The Company anticipates continued property acquisitions and exploration work, subject to funds being available for grass-roots exploration and the Company's ability to fund its other exploration priorities.

In September 2009, the Company and Bayswater Uranium Corporation ("Bayswater") agreed to modify the Itza Lake property agreement, whereby the Company may earn up to an 80% interest in the diamond rights to the Itza Property in Nunavut. The Company may earn a 60% interest in the property by issuing 76,601 common shares (with a fair value of \$49,025 at the time of issuance) and by incurring \$4,000,000 in exploration expenditures over a five year period, with a minimum first year expenditure of \$500,000. In September 2009, the agreement was amended to extend the deadline to incur the minimum first year expenditure of \$500,000 from September 1, 2009 to September 1, 2011. As of October 31, 2009, the Company had spent \$236,000 to explore the Itza property.

## **RISKS AND UNCERTAINTIES**

The risks and uncertainties faced by the Company are substantially unchanged from those described in the Company's Annual MD&A dated July 20, 2009 and its Annual Information Form ("AIF") filed July 29, 2009. These documents can be viewed under the Company's profile at: [www.sedar.com](http://www.sedar.com).

## **CURRENT QUARTER**

The Company's net loss of \$5.3 million in the three months ended October 31, 2009 (the "**Current Quarter**") was significantly higher than the \$1.2 million loss in the three months ended October 31, 2008 (the "**Comparative Quarter**") due to a larger write-off of capitalized acquisition and exploration costs (Current Quarter - \$6.1 million; Comparative Quarter - \$94,000). Total administrative expenses increased to \$798,000 in the Current Quarter, as compared to \$570,000 in the Comparative Quarter due to increases in stock-based compensation (Current Quarter -

\$279,000; Comparative Quarter - \$118,000) and office and sundry (Current Quarter - \$154,000; Comparative Quarter - \$73,000). Loss per share of \$0.02 in the Current Quarter compares to a \$0.01 loss per share in the Comparative Quarter.

*Adoption of Stock Option Policy*

Effective for the fiscal year commencing May 1, 2009, the Board of Directors approved the establishment of a program for annual stock option grants under the Company’s Stock Option Plan, with five-year option level targets, to reduce subjectivity around option grants and as a good corporate governance practise. Accordingly, the Compensation Committee made recommendations for the number of options to be granted annually for each position within the Company, as detailed below. The Plan is administered by the Company’s CEO within the program set by the Compensation Committee, and is intended to advance the interests of the Company through the motivation, attraction and retention of key employees, officers and directors of the Company. The Board of Directors of the Company is responsible for approving each grant of options under the Stock Option Plan and it has reviewed and approved the adoption of a Stock Option Grant Policy.

The Company grants stock options to many levels of employees in addition to executives. The Compensation Committee has established a program for the granting of stock options by the Company to reflect the present and potential contributions of the optionees to the success of the Company (the “Option Program”). Under the Option Program, rather than grant a large option at the beginning of a period subject to vesting terms (typically a one year period), the Company will adopt a more conservative program whereby a target number of options is set for various position levels within the Company and options will be granted in allotments of one-fifth each year. Under the Option Program, no optionee will reach his or her full allotment for five years. As the options are granted for a five year term, and after five years of employment an employee’s options will expire as to one fifth each year, to the extent that they have not been exercised, new options of a one-fifth allotment will be granted. As the options are granted at the market price at the time of grant, this reduces the exposure of the Company and the optionees to fluctuations in the market price. In addition, the opportunity for short term windfalls by optionees is reduced, as is the risk that the Company would seek to reprice options because the incentive value is lost when the share price falls below the option exercise price. The Company has not sought to reprice any stock options prior to the adoption of the Option Program.

The target option levels are as follows:

Level	Annual Allotment	5 year Target
Directors *	100,000	500,000
Executive Chair & CEO	250,000	1,250,000
Vice-Presidents	150,000	750,000
Managers	70,000	350,000
Professional Staff	50,000	250,000
Non-professional Staff	20,000	100,000
Consultants	No fixed targets	

*\*Lead Director level will receive an additional 25,000 options annually, with a 5-year target of 625,000.*

Annual stock option grants will take place as soon as practically possible after the annual general meeting and will vest immediately on the date of grant. The first option grant under the new Policy was made on October 20, 2009.

The Compensation Committee, on an extraordinary basis, may recommend bonus options, in addition to the options under the Option Program, to recognize exceptional performance on the part of an individual. Options granted over and above the annual allotment are subject to approval by the Board and will have vesting terms, to be determined at the discretion of the Board.

## SUMMARY OF QUARTERLY RESULTS

The following table sets out selected unaudited consolidated quarterly financial information of Stornoway and is derived from the unaudited quarterly consolidated financial statements prepared by management. Stornoway's interim consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and **expressed in thousands of Canadian dollars** (except for per share amounts).

Period	Interest Income <sup>(1)</sup>	Loss or (Income) from Continued Operation and Net Loss (Income)	Basic Loss (Earnings) per share <sup>(2)</sup> from Continued Operation and Net Loss (Income)	Fully Diluted Loss (Income) per share <sup>(2)</sup> - from Continued Operation and Net Loss (Income)
Three months ended October 31, 2009	\$ 8	\$ 5,272	\$ 0.02	\$ 0.02
Three months ended July 31, 2009	17	682	0.00	0.00
Three months ended April 30, 2009	18	7,471	0.03	0.03
Three months ended January 31, 2009	39	7,690	0.03	0.03
Three months ended October 31, 2008	35	1,207	0.01	0.01
Three months ended July 31, 2008	104	(11,687)	(0.06)	(0.06)
Three months ended April 30, 2008	121	5,295	0.03	0.03
Three months ended January 31, 2008	178	16,580	0.08	0.08

(1) The Company has no operating revenues.

(2) Based on the treasury share method for calculating diluted earnings.

Quarterly results will vary in accordance with the Company's exploration and financing activities. Resource property write-offs typically have the most significant impact on the Company's quarterly results. These write-offs typically vary in accordance with exploration results and changes to the Company's land position and can rarely be predicted in advance. The Company's cash flow is affected by the seasonality of the exploration business, and fluctuations in general and administrative expenses are typically seasonal as well.

The Company's activities in the Current Period have focused on an ongoing resource expansion and optimization program at the Renard Diamond Project in Quebec. The 2009 summer work at Renard conforms with Stornoway's stated objective of conducting modest, value-driven, exploration programs focused on the Company's key, advanced projects during the currently challenging resource equity environment. It compliments ongoing desktop work at Stornoway's 90% owned Aviat Project designed to provide a qualified estimate of contained value and potential mining methods for Aviat's large Eastern Sheet Complex (Stornoway Press Release dated May 05, 2009), and continuing readiness to exploit, on an opportunistic and inexpensive basis, new discovery prospects identified within Stornoway's grassroots exploration portfolio.

In a typical quarter, the Company's legal fees will increase when property option and joint venture agreements are in development and negotiation, and investor relations activities increase in proportion to shareholder inquiries, communications and as a result of the Company's periodic "roadshows". Stock-based compensation expense varies, and is dependant upon the size, timing and estimated fair value of the stock option grants. During the Current Period, the Company has continued with several measures initiated in 2008 to reduce administrative and overhead expenditures with a view towards cash preservation.

## LIQUIDITY

The Company's cash and cash equivalents decreased from \$1.6 million at April 30, 2009 to \$1.0 million at October 31, 2009. In addition, the Company has a further \$0.9 million classified as short-term deposits, of which \$259,000 is held as collateral security for the Company's credit cards. The remainder is held in a Guaranteed Investment Certificates ("GIC") that is cashable anytime after 30 days from the investment date.

In May 2009, the Company completed a brokered private placement of "flow-through" common shares for gross proceeds of \$1.4 million (see "Capital Resources" below for a description of the financing) and in June 2009, the Company received \$0.6 million relating to Quebec tax credits (accrued as of April 30, 2009). As uncertainty exists surrounding the timing and amount of these potential tax credits, the Company does not record the tax credits as receivable until a Notice of Assessment is issued. Capitalized property costs are reduced by the amount of the tax refunds received. In October 2009, the Company received proceeds of \$39,000 from the exercise of warrants.

The Company's working capital as at October 31, 2009 was \$1.4 million (April 30, 2009 - \$3.9 million), consisting mostly of cash and cash equivalents, short-term deposits and other receivables. During the Current Period, the Company's cash position decreased by \$553,000 to \$1.0 million at October 31, 2009 as compared to the six months ended October 31, 2008, where the Company's cash position decreased by \$7.2 million to \$2.4 million in cash and cash equivalents. A decrease in accounts receivable (Current Period - \$536,000; Comparative Period - \$705,000 million), write-off of resource property costs (Current Period - \$6.3 million; Comparative Period - \$321,000), stock-based compensation (Current Period - \$300,000; Comparative Period - \$267,000), a future income tax recovery of \$1.6 million (Comparative Period - \$93,000), as well as a write down of an investment in the Comparative Period (\$965,000) and a gain on early extinguishment of convertible debenture (\$13.3 million), also in the Comparative Period, represent the largest reconciling items from the consolidated statement of loss and deficit to the consolidated statement of cash flows - operating activities, for the six months ended October 31, 2009 and 2008. The Company's most significant operating expenses during the Current Period included \$260,000 for salary expense (Comparative Period - \$705,000), \$157,000 for regulatory and shareholder communications expense (Comparative Period - \$234,000), \$245,000 for office and sundry expense (Comparative Period - \$195,000) and administrative fees and rent of \$214,000 (Comparative Period - \$160,000).

The Company's primary investment activity is the acquisition and exploration of its resource property interests. During the Current Period, the Company spent \$2.4 million to explore its resource properties (Comparative Period - \$6.5 million) with the most significant expenditures on the Foxtrot (Renard) property in Quebec.

The Company's ability to generate cash is very much affected by the current market conditions, its share price and third party interest in its assets. In previous years, the Company was able to sell non-core assets as one means to finance its operations and to further exploration on its material mineral property interests. The Company's ability to sell non-core assets in the future is dependent on the number of dollars available in the current market. The decrease in available dollars in the current market also affects the Company's ability to finance its activities through the capital markets because the dilution from an equity financing increases as the share price decreases. Again, the Company is competing with other exploration companies for increasingly limited investment dollars. However, the Company is eligible for investment tax credits with respect to its exploration activities in certain provinces, which will help the Company to continue to finance its operations to some extent; however, the timing and amounts of those tax credits cannot be reliably estimated. The Company has no credit facilities that could be used for ongoing operations because it has no operating cash flow. The funds that the Company does have are invested in tranches for up to 90 days in Bankers' Acceptance ("BA") or Bankers' Deposit Notes ("BDN") issued by various chartered banks to reduce the Company's exposure to credit risk or in GICs, cashable after 30 days, which typically pay a higher interest rate than BAs or BDNs. The Company has no exposure to asset-backed commercial paper. With the early redemption of the Company's \$20.0 million convertible debenture in July 2008, the Company has no long-term debt.

The Company's most significant fixed costs relate to its leases for office space and then the costs associated with maintaining a TSX listing. The Company's minimum commitment for its premises is approximately \$405,000 per year until June 2010, decreasing to approximately \$300,000 per year between 2010 and 2013. The Company is able to reduce some of this liability through the sub-lease of excess space. The Company has sufficient financial resources to keep its material landholdings and the majority of its non-material landholdings in good standing into

2010. The Company has also incurred sufficient exploration expenditures on these properties to keep them in good standing with the respective provincial and territorial governments into 2010 as well. The Company's management actively manages its landholdings in an effort to keep those landholdings with the greatest exploration potential in good standing for as long as possible. The Company's management regularly reviews its cash position against future plans and makes decisions regarding these plans accordingly. Exploration plans in 2009 have continued to focus on the Company's 50% interest in the Renard Diamond Project, directed to a resource expansion and optimization program, with additional drilling and diamond sampling. Funds from the "flow-through" private placements, which closed in November 2008 and May 2009, have been used for the Company's share of this work. In addition, the Company is conducting in-depth reviews, compilation and analysis of its exploration data acquired over several years of fieldwork to refine specific targets of interest on its current mineral properties and to identify new areas with exploration potential. The Company's management continues to seek ways to reduce its overhead expenditures through shared administrative functions, subleases and other means.

The Company will require additional financing into 2010 to continue to develop the Renard Diamond Project, to further exploration efforts at its other Canadian mineral properties and to continue to meet its corporate and administrative expenses. In the interim, the Company is seeking to maximize the results received from its exploration efforts and to minimize variable expenses to the extent possible. The Company has no history of profitable operations and its present business is at the exploration/pre-feasibility stage. The Company 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 Company 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. Although the Company has been successful in the past in obtaining financing through the sale of equity securities or joint ventures, there can be no assurance that the Company will be able to obtain adequate financing in the future or that the terms of such financing will be favorable. Such means of financing typically result in dilution of a shareholder's interest, either directly as a result of issuing equity securities or indirectly through dilution of an interest in one of the Company's projects. Failure to obtain additional financing could result in the delay or indefinite postponement of further exploration and development of its properties and ultimately in the loss of its properties.

## **CAPITAL RESOURCES**

The Company has no operations that generate cash flow and its long-term financial success is dependant on management's ability to discover economically viable diamond deposits. The diamond exploration process can take many years and is subject to factors that are beyond the Company's control. Many factors influence the Company's ability to raise funds, including the health of the resource market, the climate for diamond exploration investment, the Company's track record and the experience and caliber of its management.

Several factors will influence the Company's cash requirements in the near future. These factors include: a decision to proceed with further development of the Renard Project in Quebec and the Company's exploration and development plans for 2010. The Company's actual funding requirements may vary from those planned due to a number of factors, including the progress of exploration activity.

The Company's exploration and development work in 2009 has focused on modest programs of value-driven exploration at its key, advanced projects. The exploration expenditures in 2009 have been financed from current cash resources (primarily from the proceeds of flow-through financing completed in November 2008 and May 2009), and work has been tailored so as to provide the most efficient use of funds. Expenditures were incurred on the following:

- Mineral resource expansion and optimization at the Renard Diamond Project. This work program resulted in an update of the National Instrument ("NI") 43-101 mineral resource statement previously announced in December 2008.
- Ongoing assessment of Stornoway's extensive grass roots exploration portfolio, including opportunistic drill testing as appropriate.

The Company has historically financed its exploration programs through the issuance of equity capital, and through the use of a convertible debenture (issued in March 2007 and extinguished in July 2008) while at the same time trying to reduce shareholder dilution by securing joint venture partners where appropriate and more recently, by the monetization of non-core assets. In recent months, Canadian equity capital markets have seen significant improvements as compared to late 2008 and early 2009. Interest in the diamond sector has also improved in recent months. The Company's management intends to continue to seek out the best opportunities to maximize shareholder value by furthering exploration programs on its most promising projects and by generating new discoveries. However, failure to secure additional financing at reasonable terms may significantly impact the Company's ability to continue as a going concern.

The Company's consolidated financial statements for the year ended April 30, 2009 and for the six months ended October 31, 2009 have been prepared in accordance with Canadian GAAP and on the basis of accounting principles applicable to a going concern, which assumes that the Company will be able to continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. There are conditions and events at the present time that cast significant doubt on the validity of this assumption, as discussed below.

In order to finance the Company's exploration programs and to cover administrative and overhead expenses, the Company historically has raised money through equity sales and from the exercise of convertible securities.

In May 2009, the Company completed a brokered private placement, with Sandfire Securities Inc. as lead agent, which consisted of 8,421,276 "flow-through" common shares of the Company for gross proceeds of \$1,431,617. The "flow-through" common shares were issued at a price of \$0.17 per share. The Company paid a 7% cash commission on certain subscriptions received and issued 568,695 Compensation Warrants (the "warrants"). The warrants are exercisable at \$0.17 to acquire one non-flow-through common share and will expire May 29, 2011. During the Current Period, a total of 227,478 warrants were exercised for gross proceeds of \$39,000. Expenditures from the flow-through shares are expected to constitute Canadian exploration expense ("CEE") (as defined in the Income Tax Act) for the 2009 tax year and must be renounced to the subscribers under the terms of the subscription agreement.

At December 10, 2009 the Company had 14,747,205 stock options outstanding which, if exercised, would increase the Company's available cash by approximately \$11.7 million. However, the average exercise price of these options is \$0.79, in excess of the Company's current market price of ~\$0.30 per share.

#### **ADDITIONAL DISCLOSURE**

Additional disclosure concerning Stornoway's general and administrative expenses and resource property costs is provided in the Company's Annual Information Form and the Consolidated Statement of Loss and Deficit and the Consolidated Schedule of Resource Property Costs contained in its Consolidated Financial Statements for April 30, 2009 and April 30, 2008 and for the six months ended October 31, 2009 and 2008. These documents are available on Stornoway's website at [www.stornowaydiamonds.com](http://www.stornowaydiamonds.com) or on its SEDAR Page Site accessed through [www.sedar.com](http://www.sedar.com)

#### **COMMITMENTS**

The Company has minimum commitments under its operating leases for its premises averaging approximately \$405,000 per year until June 30, 2010; then decreasing to approximately \$300,000 per year through 2013. A portion of these payments may be recovered through sub-leases.

In addition, the Company has GICs in the amount of \$259,000 as collateral security for its corporate credit cards and a line of credit of \$8,000 to satisfy exploration-bonding requirements. A GIC equivalent to the utilization of the line of credit is provided as collateral security. During the Current Period, the Company reduced its (collateralized) line of credit from \$1.4 million to \$8,000.

## OUTSTANDING SHARE CAPITAL

Stornoway's authorized capital is unlimited common shares without par value. As at December 10, 2009, there were 262,964,370 common shares issued and outstanding.

As at December 10, 2009, the following options are outstanding:

Number of Shares	Average Exercise Price	Year of Expiry
718,820	\$ 1.42	2010
1,392,700	\$ 1.17	2011
5,118,980	\$ 1.16	2012
4,427,205	\$ 0.47	2013
2,889,100	\$ 0.29	2014
200,400	\$ 1.12	2015
<u>14,747,205</u>		

## TRANSACTIONS WITH RELATED PARTIES

Related party transactions during the Current Period included:

- The Company paid or accrued as payable \$24,500 (October 31, 2008 - \$38,000) for the reimbursement of administrative and technical time to Strongbow Exploration Inc. ("Strongbow"), a company related by virtue of a common director;
- In May 2007, the Company entered into a sub-lease agreement with Agnico-Eagle Mines Limited ("Agnico-Eagle"), a significant shareholder and a company with a director in common, for additional premises. The Company is committed to annual lease payments of approximately \$105,000 in respect of these premises through June 30, 2010. A portion of these payments may be recovered through sub-leases;
- The Company paid, or accrued as payable on behalf of the Eastern Ungava JV, \$13,200 (October 31, 2008 - \$122,000) to Agnico-Eagle, of which the Company's share is 50%, for work completed by Agnico-Eagle related to a preliminary assessment at the Renard Project (Foxtrot Property).

The above transactions, occurring in the normal course of operations, are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

As at October 31, 2009, the other receivables included \$1,000 due from Strongbow (April 30, 2009 - \$2,000 payable) and amounts due to related parties consisted of \$5,000 (April 30, 2009 - \$3,000) due to Agnico-Eagle.

These amounts are non-interest bearing, unsecured and are due on demand.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of the Company's consolidated financial statements requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as well as the reported expenses during the reporting period. Such estimates and assumptions affect the determination of the potential impairment of long-lived assets, estimated costs associated with reclamation of exploration properties, and the determination of stock-based compensation and future income taxes. Estimates and assumptions may be revised as new information is obtained, and are subject to change. Management believes that the Company's accounting policies and the estimates used in the preparation of the consolidated financial statements are appropriate in the circumstances, but are subject to judgments and uncertainties that are inherent in the financial reporting process. Actual results could differ from estimates and the differences could be material. The most critical accounting policies upon which the Company depends are those requiring estimates of impairment, assumption about fair value and future income taxes. Please refer to Note 3 of the audited,

consolidated financial statements of the Company for the years ended April 30, 2009 and 2008 for a description of all significant accounting policies.

#### *Impairment of long-lived assets*

The Company capitalizes all costs related to investments in resource property interests on a property by-property basis. Such costs include resource property acquisition costs, and exploration and development expenditures, net of any recoveries. Costs are deferred until such time as the extent of mineralization has been determined and resource property interests are either developed or the Company's mineral rights are allowed to lapse.

The Company's management reviews the carrying value of the Company's mineral properties when there are events or circumstances that may indicate impairment. In making an assessment of the potential impairment of the Company's mineral property interests, management has used estimates of future mineral prices, mineral resource quantities, and operating, capital and reclamation costs, as well as making judgments on the potential of certain projects based on the available information at the balance sheet date. These estimates are subject to certain risks and uncertainties that may affect the determination of the recoverability of deferred mineral property interests. Although management has made its best estimates of potential impairment, the interpretation these factors is subjective and do not necessarily result in precise determinations. Should an underlying assumption change, the resulting estimates could change by a material amount.

All deferred resource property expenditures are reviewed, on a property-by-property basis, to consider whether there are any conditions that may indicate impairment. When the carrying value of a property exceeds its net recoverable amount that may be estimated by quantifiable evidence of an economic geological resource or reserve, expenditure commitments or the Company's assessment of its ability to sell the property for an amount exceeding the deferred costs, a provision is made for the impairment in value.

The Company's most significant long-lived asset consists of capitalized acquisition and exploration costs for its resource properties. The Company's resource properties are at three different stages:

- a) development (Renard);
- b) advanced exploration (Aviat, Churchill and Qilalugaq); and
- c) grass-roots exploration.

To test for impairment on its resource properties, management uses an undiscounted future cash flow method for the development stage project; an estimate of "in-situ" value for the advanced projects and the criteria set out in Paragraphs 16 and 18 of Accounting Guideline 11 – Enterprises in the Development Stage for the grass-roots exploration projects.

The National Instrument 43-101 report ("NI 43-101") filed by the Company in December 2008 contains a detailed cash flow model, with a "base-case" and an "upside" scenario. Management has evaluated the cash flow model under both scenarios against the carrying value of the Renard Diamond Project and is of the opinion that the estimated future cash flows (undiscounted) from the project exceed its carrying value of \$131.4 million as at October 31, 2009 and that no write-down for impairment is warranted on this basis. Management strongly believes in the potential upside value of the Renard Project through the expansion of the resource estimate and through long-term diamond price growth. These factors are expected to be incorporated into an updated NI 43-101 technical report in January 2010.

Without an estimate of future undiscounted cash flows, other methods must be used to estimate fair value. Management believes that using an estimate of "in-situ" value for its advanced projects is a reasonable way to estimate fair value. The in situ method is a broad metric of project value, which uses an estimate of carats contained in the project and an estimate of carat value, factored to account for extracted value. A factor is applied to provide a risk adjusted expectation of value and also adjusts for value recovered and capital expenditures, operating costs and income tax expenses. The three advanced projects are all located within the Rae Craton in Nunavut and have approximately equivalent emplacement ages. Management has enough information to make a reasonable estimate of the contained carats for each project based on information available to date. Using a low-average-high range estimate of per carat values and a simple range of probabilities, combined with a low factor, a low and high estimate of fair value for each project was calculated. While these estimated fair values exceeded the current carrying values

of the Aviat and Qilalugaq properties, the estimated fair values calculated for the Churchill Project were lower than its current carrying value. Accordingly, the Company wrote-down the carrying value of the Churchill Project by \$6.8 million during the year ended April 30, 2009. Management determined that no further write-downs were required as of October 31, 2009.

The Company uses the guidance set out in AcG-11 as the basis for determining whether its grass-roots properties should be written off. Paragraph 16 AcG-11 sets out factors that may indicate the need for a write-down:

- a) unfavourable changes in the property or project economics;
- b) an inability to access the site;
- c) environmental restrictions on development;
- d) an inability to create an efficient distribution mechanism; and
- e) political instability of the region in which the property is located.

Paragraph 18 AcG-11 states: “In addition to the above general presumption, there should be a presumption of impairment in the carrying amount of property, plant and equipment and intangible assets of enterprises in the development stage engaged in extractive operations when any of the following conditions exist:

- a) the enterprise’s work program on a property has significantly changed so that previously identified resource targets or work programs are no longer being pursued;
- b) exploration results are not promising and no more work is being planned for the foreseeable future; or
- c) remaining lease terms are insufficient to conduct necessary studies or exploration work.

Using these conditions as a guideline for estimating whether an impairment exists on its grass-roots properties, and based on the Company’s plan to further evaluate and advance these properties by analyzing results received to-date, management has determined that the carrying values of certain of its grass-roots resource properties as of October 31, 2009 and as of the report date should be written-off, as no future exploration work is planned for the foreseeable future and limited exploration work has been carried out on the properties during the last three years. During the Current Period, the Company wrote-off capitalized property interests of \$6.3 million. The majority of this write-off (\$6,023,000) relates to properties in Nunavut (\$5,330,000) and Eastern Canada (\$693,000) where no future exploration programs are planned for the foreseeable future. In addition, the Company wrote-off \$286,000 for generative exploration and other, non-material property interests in Canada where no future exploration is warranted or where the Company no longer retains a property interest.

#### *Asset retirement obligations*

Asset retirement obligations are the estimated costs associated with reclamation of the Company’s resource properties and are recorded as a liability at fair value. The liability is accreted over time through periodic charges to operations. In addition, asset retirement costs are capitalized as part of each asset’s carrying value at its initial discounted value and are amortized over the asset’s useful life. In the event the actual costs of reclamation exceed the Company’s estimates, the additional liability for retirement and remediation costs may have an adverse effect on the Company’s future results of operations and financial condition. The Company’s asset retirement obligation relates to activities at its Renard Project in Quebec. At this time, the potential asset retirement obligations in respect of the Company’s exploration camps cannot be reasonably estimated.

#### *Stock-based compensation*

The Company’s current market price and the volatility of the Company’s market price will affect the estimates made for stock-based compensation. The volatility of the Company’s stock price and the stock price at the grant date have the most significant impact on the estimate of fair value of stock-based compensation. The Company expenses stock-based compensation for its corporate and administrative employees and capitalizes stock-based compensation expense for its exploration and technical staff.

Stock-based compensation is accounted for using the fair value based method. Under the fair value based method, compensation cost is measured at fair value of the options at the date of grant and is expensed over the vesting

period of the award. The Company estimates the fair value using the Black-Scholes option-pricing model. The key assumptions used during the Current Period were: a risk-free interest rate of 2.5% ~ 2.7%, a dividend yield of 0%, an expected volatility of 83% ~ 94% and expected term of stock options of 3 ~ 5 years. The key assumptions used during the year ended April 30, 2009 were: a risk-free interest rate of 1.9%, a dividend yield of 0%, an expected volatility of 86% ~ 92% and expected term of stock options of 3 ~ 5 years. Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options.

During the Current Period, the Company recorded stock-based compensation expense of \$494,000 (October 31, 2008 - \$267,000), of which \$194,000 (October 31, 2008 - \$207,000) has been capitalized to resource property costs. The Company granted 3,395,000 stock options during the six months ended October 31, 2009. The options have an exercise price of \$0.25 and expire between four to five years from the grant date. The Company used the Black-Scholes Option Pricing Model to estimate a fair value of \$543,000 for this grant. During the year ended April 30, 2009 the Company granted options to purchase up to 3,478,500 shares of the Company's stock to employees and non-employees at an exercise price of \$0.10. The Company used the Black-Scholes Option Pricing Model to estimate a fair value of \$138,000 for these grants.

The Company also uses the Black-Scholes option-pricing model to value other share compensation. During the Current Period, the Company issued 568,695 warrants as part of a brokered private placement. These warrants were estimated to have a fair value of \$41,400, using the Black-Scholes option-pricing model with the following assumptions: 1.23% risk-free interest rate; two-year term, 97.6% volatility.

#### *Future income tax assets and liabilities*

Future income tax assets and liabilities are measured using statutory rates that are expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The Company recorded a future income tax liability as part of the acquisition of Ashton and Contact and made certain assumptions with respect to the values of certain of Ashton and Contact's tax pools and loss-carryforward balances. Differences in the actual tax rates applied and in the timing of the settlement of temporary differences could have a material impact on the Company's reported tax assets and liabilities.

## **CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION**

### **Initial Application of Accounting Standards**

#### *Goodwill and Intangible Assets*

Effective May 1, 2009, the Company adopted CICA Handbook Section 3064, which establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of pre-production and start-up costs and requires these costs be expensed as incurred unless the costs meet the asset recognition criteria. The adoption of this section did not have a significant impact on the Company's consolidated financial statements.

#### *Business Combinations*

In January 2009, the CICA issued Section 1582, Business Combinations, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. In addition, the CICA issued Sections 1601, Consolidated Financial Statements, and 1602, Non-Controlling Interests, which replaces the existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements, while section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination.

These statements apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011 with earlier application permitted. The Company is currently evaluating the new sections to determine the potential impact on its consolidated financial statements.

### *International financial reporting standards*

The Canadian Accounting Standards Board recently confirmed that International Financial Reporting Standards (“IFRS”) will replace Canadian standards and interpretations on January 1, 2011. The process of changing from current Canadian GAAP to IFRS will be a significant undertaking that may materially affect reported financial position and results of operations, and also affect certain business functions.

The Company has not yet completed a full evaluation of the adoption of IFRS and its impact on its financial position and results of operations. The full evaluation and an implementation plan will be completed before April 30, 2010. The progress of the evaluation and implementation plan will be addressed in the Company’s quarterly and annual MD&As for the year-ended April 30, 2010. The evaluation and implementation plan will address the impact of IFRS on:

- Accounting policies, including choices among policies permitted under IFRS and implementation decisions such as whether changes will be applied on a retrospective or a prospective basis;
- Information technology and data systems;
- Internal control over financial reporting;
- Disclosure controls and procedures, including investor relations and external communications plans;
- Financial reporting expertise, training requirements and the need for assistance from outside expertise;
- Post implementation monitoring to access any future developments of IFRS.

### **FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

The Company’s financial instruments consist of cash and cash equivalents, short-term deposits, other receivables, investments, accounts payable, accrued liabilities and amounts due to related parties.

The fair values of financial instruments at October 31, 2009 and April 30, 2009 are summarized as follows (*expressed in thousands of dollars*):

	<b>October 31, 2009</b>		<b>April 30, 2009</b>	
	<b>Carrying amount</b>	<b>Fair value</b>	<b>Carrying amount</b>	<b>Fair value</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Financial Assets</b>				
<i>Held for trading</i>				
Cash and cash equivalents	<b>997</b>	<b>997</b>	1,550	1,550
Short-term deposits	<b>944</b>	<b>944</b>	1,344	1,344
<i>Loans and Receivables</i>				
Other receivables	<b>1,615</b>	<b>1,615</b>	1,984	1,984
<i>Available for sale</i>				
Investments	<b>265</b>	<b>265</b>	555	555
<b>Financial Liabilities</b>				
Accounts payable and accrued liabilities	<b>2,515</b>	<b>2,515</b>	1,938	1,938
Due to related parties	<b>5</b>	<b>5</b>	5	5

Unless otherwise noted, it is management’s opinion that the Company is not exposed to significant interest, foreign currency or credit risks arising from these financial instruments.

The Company is exposed to a variety of financial risks by virtue of its activities, including credit risk, interest rate risk and liquidity risk. The Company has limited exposure to foreign currency risk as greater than 99% of its assets and 100% of its liabilities are denominated in Canadian dollars. The Company’s objective with respect to risk management is to minimize potential adverse effects on the Company’s financial performance. The Company’s Board of Directors provides direction and guidance to management with respect to risk management. Management is responsible for establishing controls and procedures to ensure that financial risks are mitigated to acceptable levels.

### *Credit risk*

Credit risk is the risk of financial loss to the Company if a counter-party to a financial instrument fails to meet its contractual obligations. The Company manages credit risk by investing its excess cash in short-term investments with an investment grade rating of “AAA” (R-1 high for money market securities) or better, issued by a Canadian chartered bank. The Company is exposed to credit risk by virtue of its receivables from companies with which it has exploration agreements or options (approximately 80% of receivables totaling \$1.3 million at October 31, 2009). The remainder of the Company’s receivables at the balance sheet date consist of federal and provincial sales tax refunds where management believes the risk of loss to be remote. The maximum exposure to credit risk at the reporting date is the carrying value of the Company’s receivables.

### *Interest rate risk*

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates. Financial assets and liabilities with variable interest rates expose the Company to interest rate risk with respect to its cash flow. The risk that the Company will realize a loss as a result of a decline in the fair value of any short-term investment included in cash and cash equivalents is limited because these investments, although readily convertible into cash, are generally held to maturity. As of October 31, 2009, management estimates that if interest rates had changed by 1% for those funds invested in GICs, and 0.05% for the other cash equivalents assuming all other variables remained constant, the impact on the Company’s loss for the six months ended October 31, 2009 would have been approximately \$7,500.

### *Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its obligations as they become due. The Company’s ability to continue as a going concern is dependent on management’s ability to raise the funds required through future equity financings, asset sales or exploration option agreements, or a combination thereof. The Company has no regular cash flow from its operating activities. The Company manages its liquidity risk by forecasting cash flow requirements for its planned exploration and corporate activities and anticipating investing and financing activities. Failure to realize additional funding, as required, could result in the delay or indefinite postponement of further exploration and development of the Company’s properties. As at October 31, 2009, the Company had cash and cash equivalents, and short-term deposits of \$1.9 million (April 30, 2009 - \$2.9 million), as well as receivables of \$1.6 million to settle current liabilities of \$2.5 million (April 30, 2009 - \$1.9 million). See Note 16 of the interim, consolidated financial statements for the six months ended October 31, 2009 for details on other commitments. Additional information regarding liquidity risk is disclosed in Note 1 of the interim, consolidated financial statements for the six months ended October 31, 2009.

## **CAPITAL MANAGEMENT**

The Company’s objectives when managing capital are to:

- a) Safeguard the Company’s ability to continue as a going concern,
- b) Have sufficient capital to continue to acquire, explore and develop the Company’s mineral properties, and
- c) Provide sufficient funds for the Company’s corporate activities.

The capital of the Company consists of the items included in shareholder’s equity. The Company’s mineral properties are in the exploration stage. As an exploration stage company, the Company is currently unable to self-finance its operations. The Company has historically relied on equity financings and, more recently, the monetization of non-core assets and a convertible debenture to finance its operations. In order to carry out the Company’s planned exploration programs and to pay for administrative costs, the Company will spend its existing working capital and raise additional funds as required. To effectively manage the Company’s capital requirements, the Company’s management has in place a planning and budgeting process. The Company is not subject to any externally imposed capital requirements. Additional information regarding capital management is disclosed in Note 1 of the interim, consolidated financial statements for the six months ended October 31, 2009.

## **DISCLOSURE CONTROLS**

The Company's Chief Executive Officer and Chief Financial Officer (the "Certifying Officers") are responsible for establishing and maintaining disclosure controls and procedures ("the Procedures") which provide reasonable assurance that information required to be disclosed by the Company under provincial or territorial securities legislation (the "Required Filings") is reported within the time periods specified. Without limitation, the Procedures are designed to ensure that material information relating to the Company is accumulated and communicated to management, including its Certifying Officers, as appropriate to allow for timely decisions regarding the Required Filings.

The Certifying Officers evaluated the effectiveness of the Procedures during the Current Period and have concluded that the Procedures in place as of the end of the fiscal period covered by the Required Filings are effective in providing reasonable assurance that material information relating to the Company is accumulated and communicated to management and reported within the time periods specified.

## **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

The Certifying Officers are responsible for designing a system of internal controls over financial reporting, as defined under National Instrument 52-109, which provides reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of its interim and annual consolidated financial statements in accordance with the Company's GAAP.

The Certifying Officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Company's internal controls over financial reporting as of October 31, 2009 and have concluded that the Company's internal controls over financial reporting are effective, and are sufficiently designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of its consolidated financial statements for external purposes in accordance with the Company's GAAP. This evaluation was completed using the framework and criteria established in the Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). There have been no changes in internal control over financial reporting during the six months ended October 31, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

## **APPROVAL**

The Board of Directors of Stornoway has approved the disclosure contained in this Interim MD&A. A copy of this Interim MD&A will be provided to anyone who requests it.

## **ADDITIONAL INFORMATION**

Additional information relating to Stornoway is on SEDAR at [www.sedar.com](http://www.sedar.com).