



(US dollars, except where noted)

(Unit of weight is US short tons)

## Management's Discussion and Analysis Quarter Ending March 31, 2014

The following discussion and analysis of the financial condition and operations of Polaris Minerals Corporation (the "Company") has been prepared by management as of May 8, 2014, and should be read in conjunction with the Company's unaudited interim consolidated financial statements for the three months ended March 31, 2014, which have been prepared in accordance with International Financial Reporting Standards ("IFRS") for interim financial reporting, and the audited annual consolidated financial statements for the year ended December 31, 2013, which have been prepared in accordance with IFRS. This Management's Discussion and Analysis contains "forward-looking statements" that are subject to risk factors set out in a cautionary note contained herein. All amounts are in United States dollars unless otherwise noted.

### Highlights

- **Financial metrics improved in the quarter continuing the positive trends seen throughout last year with sales and revenue reflecting a planned lower level of winter shipments;**
- **Gross loss in the quarter of \$313,000 was a reduction of 47% from the loss of \$589,000 recorded in the same winter quarter last year;**
- **The Company committed to developing its future terminal in Long Beach, California, on the site that it has leased since 2010.**

### Results of Operations

During this winter quarter ended March 31, 2014, the Company planned a modest shipping schedule to San Francisco Bay in order to minimize the risk of significant deadfreight charges arising through unpredictable winter weather conditions. Market demand for the full 2014 year is expected to be significantly higher than last year, based on our contracted customers' indicated requirements, consequently shipments in the second quarter have increased substantially in order to meet this increasing demand from the principal market in northern California. During the quarter the Company benefited from certain selling price increases implemented throughout the period, with further increases in sales prices anticipated in the remainder of 2014. Also during the first quarter of 2014, the Company reported reduced cost of goods sold per ton, as customer sales mix reduced delivery costs and production efficiencies reduced costs at the Orca quarry. Current demand reflects continuing growth in the base business boosted by major contract requirements which, coupled with anticipated price enhancements, should further increase revenues and improve operational efficiencies.

(000's, except per ton amounts)	Three months ended March 31,			
	2014		2013	
	Tons	\$	Tons	\$
Sales	632	8,528	773	10,524
Gross loss		(313)		(589)
<i>Gross loss per ton</i>		<i>(0.50)</i>		<i>(0.76)</i>

#### **Revenue and tons sold**

Revenue for the three months ended March 31, 2014 decreased by 19% to \$8.5 million, compared with \$10.5 million for the three months ended March 31, 2013. Aggregate sales for the current quarter were 632,000 tons, an 18% decrease over sales of 773,000 tons in the first quarter of 2013.



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The average selling price ("ASP") during the current quarter of \$13.49 per ton decreased from \$13.61 per ton in the same period of 2013. The decrease in ASP reflects additional volumes sold on a Free-On-Board ("FOB") basis at the Orca Quarry under the supply agreement that commenced in February 2013 offset by increased selling prices on the long-term contracted business. Because the new supply agreement does not include freight charges for shipping to California it has a significantly lower selling price per ton. ASP per ton is also influenced on a quarter by quarter basis by shipping fuel surcharges and the distribution of tonnage delivered to the various California terminals because delivered prices and costs, and therefore selling margins, vary at each location. The tonnage sold in any particular quarter can be significantly affected, positively or negatively, by the timing of specific voyages delivering product into San Francisco Bay although this issue is becoming less significant as volumes increase.

#### ***Cost of goods sold***

Cost of goods sold for the three months ended March 31, 2014 decreased by 20% to \$8.8 million from \$11.1 million for the three months ended March 31, 2013. Accordingly, cost of goods sold per ton for the current quarter declined to \$13.99 compared to the cost of goods sold per ton for the same period in 2013 of \$14.38. The additional volumes supplied under the agreement that commenced in February 2013 do not include freight charges. As the current quarter benefited from a complete quarter of the reduction it contributes to the year-on-year reduction in overall cost of goods sold per ton. Additionally, current quarrying costs have benefited from improved productivity following refurbishment of the main crusher and installation of a new primary screening station early in 2013.

The Company's shipping costs are denominated in US dollars. Costs at the Orca Quarry are incurred in Canadian dollars and as such are susceptible to fluctuations in foreign exchange rates upon reporting. Additionally, fixed quarry costs per ton fluctuate significantly with the level of production.

#### ***Gross profit (loss)***

For the quarter ended March 31, 2014, the Company incurred a gross loss of \$0.3 million compared with a gross loss of \$0.6 million in the first quarter of 2013. The gross loss per ton was \$0.50 for the three months ended March 31, 2014, a \$0.26/ton improvement over the gross loss per ton of \$0.76 in the first quarter of 2013. This significant reduction is largely due to increased selling prices and improved productivity at the quarry that enabled the Company to operate more efficiently. In addition, the benefit from the supply agreement noted above contributed to an improvement in gross margin by reducing overall freight costs.

#### ***Selling, general and administrative costs***

During the three months ended March 31, 2014, selling, general and administrative expenses of \$1.3 million, increased 20% compared with \$1.1 million in the same period for 2013. The increase in 2014 general and administrative costs is principally due to higher share-based employee benefits expense, a non-cash charge.

#### ***Net loss***

The Company incurred a net loss attributable to shareholders of \$1.5 million (\$0.02 per share loss) during the three months ended March 31, 2014, compared to a net loss attributable to shareholders of \$1.9 million (\$0.03 per share loss) during the three months ended March 31, 2013. Significantly reduced financing expenses contributed to the improvement in net loss, as the Company's long term debt was paid off in the second quarter of 2013.

## **Segmented Analysis**

The Company operates in one segment: the development and operation of construction aggregate properties and projects located in the United States and Canada.



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## Summary of Quarterly Results

The selected financial information set out below is based on and derived from the unaudited consolidated financial statements of the Company for each of the quarters listed:

(\$000's)	2014	2013				2012		
	Mar 31	Dec 31	Sept 30	June 30	Mar 31	Dec 31	Sept 30	June 30
Revenue	8,528	14,067	9,398	10,904	10,524	8,305	9,130	7,659
Gross profit (loss)	(313)	1,234	(118)	(503)	(589)	(1,009)	(1,653)	(678)
Earnings (loss) before interest and income taxes	(1,671)	88	(2,967)	(2,538)	(1,643)	(2,034)	(3,176)	(2,116)
Net income (loss)	(1,597)	339	(3,062)	(3,824)	(2,088)	(2,734)	(3,742)	(2,150)
Net income (loss) attributable to shareholders of Polaris	(1,526)	63	(2,847)	(3,545)	(1,879)	(2,631)	(3,413)	(1,886)
Basic and diluted net loss per share	(0.02)	0.00	(0.03)	(0.05)	(0.03)	(0.05)	(0.06)	(0.04)
(000's Tons)								
Sales	632	1,068	687	836	773	571	632	535
Aggregate production	776	1,009	770	866	641	619	511	615

See *Customers* section for discussion of quarterly and general trends.

## Liquidity and Capital Resources

The Company's primary sources of liquidity and capital resources are cash on hand and other working capital items, finance leases for the procurement of heavy equipment, and access to capital markets. The Company manages its working capital and long-term capital structure and resources in order to minimize the cost of capital while properly managing credit, liquidity, and market risks.

### Working Capital

At March 31, 2014, the Company had working capital of \$10.2 million that included cash of \$7.0 million. Comparatively, at December 31, 2013 the Company had working capital of \$11.8 million and cash of \$9.4 million.

### Operating, Financing and Investing Activities

During the three months ended March 31, 2014 the Company used cash for operations of \$1.4 million (\$2.17 per ton). During the three months ended March 31, 2013, the cash used for operations was \$2.0 million (\$2.54 per ton). Operating cash flows were negatively impacted by changes in working capital accounts, mainly in settling trade payable accounts which were at higher levels at December 31, 2013 as a function of the higher production and sales volumes in the fourth quarter of 2013 relative to the current quarter. In particular, shipping costs and volume based royalty payments were paid down in the current quarter. The balance of the operating cash outflow was used in supporting the Company's operations.

For the three months ended March 31, 2014 financing activities provided cash of \$0.1 million compared to cash used by financing activities of \$0.1 million for the same period in 2013. Financing activities for the three months ended March 31, 2014 related mainly to the issuance of common shares on exercise of stock options and warrants, offset by principal repayments for the finance leases of mining equipment used at the Orca Quarry.

Investing activities during the three months ended March 31, 2014, used cash of \$0.8 million compared to cash used of \$0.5 million for three months ended March 31, 2013. Investing activities for the three months ended March 31, 2014 are mainly attributable to purchases of plant equipment at the Orca quarry along with site development costs and deposits on equipment for the Long Beach terminal project.



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## **Contractual Obligations, Commitments and Contingencies**

### *Shipping Tonnage*

The Company has a Contract of Affreightment (“NCoA”) which is effective from January 1, 2010 with a term of 20 years. The NCoA requires the Company to ship minimum tonnages per year. On December 19, 2013 the Company and its exclusive shipper amended the NCoA to reflect changes in the operation of the contract that included a fixed annual minimum tonnage commitment of 2,970,000 tons in each of the remaining years of the contract. The Company has the option in any given year to increase or decrease the annual commitment by 10% without penalty. Sales under the Company’s supply agreement that commenced February, 2013, are FOB shipping point and are not included toward the Company’s minimum shipping commitment. Failure by the Company to ship its annual cargo commitment will result in a dead-freight charge equal to 75% of the freight rate for the unshipped tons. Minimum freight volume penalties are payable annually in the first quarter following the year in which freight volumes do not meet the minimum volume requirements in the NCoA. The Company did not pay penalties in respect of the 2013 year.

### *Royalty Assessment for Eagle Rock Quarry Project*

The Company is disputing a royalty assessment for 2012 and 2013. During the first quarter of 2014, the Company’s subsidiary Eagle Rock Materials Ltd. was notified by the British Columbia Ministry of Forests, Lands and Natural Resource Operations that royalties were due of CAD\$456,000 for 2012 and CAD\$496,000 for 2013, based on the tenure date, in respect of the Company’s quarrying lease for the Eagle Rock Quarry project. The Company position is that royalties are only payable based on actual production, in accordance with a written undertaking from the responsible government agency prior to commencement of the lease, and as the project has not been developed, no royalties are currently due. Accordingly, the Company has not recorded a provision for the royalties.

## **Non-GAAP Measures**

### *Adjusted Loss*

The Company has prepared a calculation of adjusted loss for the period in order to better reflect underlying business performance by removing certain non-cash adjustments from its IFRS calculation of loss as it believes this may be a useful indicator to investors. Adjusted loss may not be comparable to other similarly titled measures of other companies.

	Three months ended March 31,	
(\$000’s, except per share and per ton amounts)	2014	2013
Net loss for the period attributable to shareholders of Polaris	(1,526)	(1,879)
Adjustments		
Share-based employee benefits	173	28
Other (gains) and losses	(2)	(116)
Adjusted net loss for the period	(1,355)	(1,967)
<i>per share</i>	<i>(0.02)</i>	<i>(0.03)</i>
<i>per ton</i>	<i>(2.14)</i>	<i>(2.54)</i>

### **EBITDA and Adjusted EBITDA**

EBITDA, adjusted EBITDA, EBITDA per share and adjusted EBITDA per share (“EBITDA Metrics”) are non-IFRS financial measures. EBITDA and EBITDA per share represent net income, excluding income tax expense, interest expense and amortization and accretion. Adjusted EBITDA and adjusted EBITDA per share better reflects the underlying business performance of the Company by removing certain non-cash adjustments from its calculation of EBITDA and EBITDA per share. The Company believes that the EBITDA Metrics trends are valuable indicators of whether its operations are generating sufficient operating cash flow to fund working capital needs and to fund capital expenditures. The Company uses the results depicted by the EBITDA Metrics for these purposes, an approach utilized by the majority of public companies in the construction materials sector. The EBITDA Metrics are intended to provide additional information, do not have any standardized meaning prescribed by IFRS and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS. These measures are not necessarily indicative of operating profit or cash flow from operations as determined under IFRS. Other companies may calculate these measures differently.



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The following table reconciles these non-GAAP measures to the most directly comparable IFRS measure.

	Three months ended March 31,	
	2014	2013
(\$000's except per share and per ton amounts)		
Net loss for the period attributed to shareholders of Polaris	(1,526)	(1,879)
Interest	20	262
Income tax	(94)	130
Amortization, depletion and accretion	1,125	1,121
EBITDA	(475)	(366)
<i>per share</i>	(0.01)	(0.00)
<i>per ton</i>	(0.75)	(0.47)
Adjustments		
Share-based employee benefits	173	28
Other (gains) and losses	(2)	(116)
Adjusted EBITDA	(304)	(454)
<i>per share</i>	(0.00)	(0.01)
<i>per ton</i>	(0.48)	(0.58)

## Overview of the Company, Operations, Markets and Outlook

### MARKET OUTLOOK AND RECENT DEVELOPMENTS

Sales in the first quarter of 2014, the winter quarter, were 632,000 tons, a decrease of 18% over the first quarter of 2013 which was not a reflection of market conditions, but simply prudent winter planning in respect of shipping. Sales under the Company's two existing long term supply and marketing agreements decreased by 19%, with the balance being principally the contribution from a new supply agreement that commenced in February. Demand in the northern California market is increasing as private housing, private commercial, and public infrastructure sectors all continue to recover. In February, 2013 the Company commenced supplies under a new contract with an international construction materials company which was already engaged in importation of aggregates by ocean-going vessels into the San Francisco Bay. The contract is for an initial period of three years with two option periods of three years which, with the mutual agreement of both parties, could extend the contract to a total of nine years. Under this new contract aggregates are loaded at Orca Quarry into vessels chartered by the customer.

The continuing strong increase in northern California's demand coupled with the increasing use of the high quality Orca aggregate to meet exacting specifications for use in concrete is enabling the Company to achieve real price increases. The Company believes that the increasing level of demand being experienced by its California customers is the result of investment factors specific to the greater San Francisco area which have been evident ahead of the broader US construction recovery now underway. During the quarter, supply commenced to a major contract secured by a contracted customer. To meet the requirements of this contract, a smaller self-discharging vessel has been provided by CSL. Securing this contract represented a significant cooperation between the parties involved. This contract will run throughout 2014, provisionally ending during the first half of 2015.

In the US, the aggregates market nationally is being impacted through uncertainty regarding the future funding for highways. However, on April 29<sup>th</sup>, the Secretary of the US Department of Transportation unveiled a four-year, \$302 billion, surface transportation reauthorization bill termed the "Grow America Act". This bill would also provide \$87 billion of funds to shore up the Highway Trust and includes measures proposed to expedite project delivery. Additionally, states are able to apply for funding assistance under the Transportation Infrastructure Finance and Innovation Act (TIFIA) which will provide \$1.75 billion of Federal credit assistance over the next two years for nationally or regionally significant surface transportation projects. Each dollar of Federal funds can provide up to \$10 in TIFIA credit assistance, leveraged up to \$30 in transportation infrastructure investment. In September, 2013, the



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Portland Cement Association published an updated forecast that predicted cement consumption would increase by 4% in 2013 and then increase by 9.7% in each of 2014 and 2015 to be followed by an 11% consumption gain in 2016. It has to be noted that alongside this optimism was a caution that US economic factors are still uncertain in many areas.

In respect of private sector construction investment, the Company believes that the encouraging statistics showing a resurgence in private housing will continue. Although this sector is less influential on the demand for Orca Quarry materials than private commercial investment, it is nonetheless helpful that each sector of the construction economy recover towards normalized levels enabling a return to logical competitive factors. Increased multiple occupancy unit construction activity in San Francisco, coupled with strong private commercial activity, particularly in the San Francisco/San Jose corridor is contributing significantly to increasing demand for Orca Quarry product. House prices are reported to be increasing strongly in the San Francisco market which can be expected to benefit housing starts and commercial development to the north of the Golden Gate Bridge an area that has lagged behind the general upsurge in demand around the Bay.

Local reserves of construction aggregate continue to decline and the development of new replacement quarries is still strongly opposed by local residents in most markets, especially those crucial to our business. The California Geological Survey released a report titled "Aggregate Sustainability in California, 2012" which is essentially an update to similarly titled reports published in 2002 and 2006. The report contains a considerable amount of data which demonstrates that aggregate shortages remain a major problem such that in a number of major markets in the State, where aggregate resources continue to decline, they are not being replaced, and complete exhaustion can be projected in a decade or so. Despite these dire predictions, the quarrying industry's problems in permitting new resources have not changed and it remains extremely difficult, especially around major urban markets, to obtain new permits. The Company's development strategy has been delayed by the severe economic recession that began in 2008 but the fundamental principles remain and future sources of aggregate, particularly sand and gravel, will be considerably further from the ports serviced by Orca aggregate which will place further upward pressure on selling prices.

Recent examples of the difficult resource permitting climate are the refusal to permit a proposed large new granite quarry in Riverside County north of San Diego and a hard rock quarry proposed near Fresno, both of which failed due to the high level of public concern about such new operations. The January 2011 San Diego Region Aggregate Supply Study prepared under the direction of SANDAG (San Diego Area Governments) stated; "One of the challenges facing this region is how to meet the increasing demand for aggregate at a time when the local supply is shrinking", this being particularly with reference to materials necessary to meet planned public sector expenditure. The report highlighted the need for further land based resources, coupled with the requirement to import materials by ship, train or barge and supports the Company's strategy to supply this market.

In Hawaii, the Company is focusing on major infrastructure projects where the ability of Orca Quarry materials to meet stringent performance requirements provides strong technical and economic justification for their usage. The initial term of the Company's supply agreement with its Hawaiian customer has expired although sales are continuing at previous levels under normal purchase and supply arrangements. During April, 2013, a major trial at the Hickam Air Force Base was supervised by the US Army Corps of Engineers. The trial involved concrete paving for runway construction made exclusively from Orca aggregate. It is pleasing to note that the results were extremely positive. This will eventually begin to benefit sales although the Company recognizes that the expected increase in volumes would be modest in comparison to California demand.

Relatively small quantities of materials continue to be sold for use in British Columbia or Alaska and are loaded into barges provided by the customers.

## **OPERATIONS**

### ***Quarry Properties***

The Orca Quarry is situated to the west of the town of Port McNeill, British Columbia, and commenced shipments of high quality sand and gravel construction aggregates to west coast ready mix concrete producers in March 2007. Mineral extraction takes place from the East Cluxewe deposit which contained a reserve of 134 million tons at the commencement of operations in 2007. Estimates of remaining reserves are contained in the Company's Annual Information Form.

The Company has also explored additional lands in the Orca Quarry area, over which it has certain rights, referred to as the East Cluxewe Extension and West Cluxewe deposits. After due consideration of the resource, environmental and permitting factors relative to these areas, the Company anticipates that, following completion of extraction of the



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East Cluxewe deposit, working the East Cluxewe Extension deposit, which is contiguous with its current operations, will be the first priority to be followed by the West Cluxewe deposit. The necessary permits for working these additional deposits will be sought much nearer the time when they will be required.

The Company also owns the rights to develop the Eagle Rock Quarry Project, a very large granite resource located on deep tidewater alongside the Alberni Inlet near Port Alberni, British Columbia. The Eagle Rock Quarry received its mine permit in 2003 and in 2008 renewed the Environmental Assessment Certificate from the Province of BC, which expired in September 2013. The Company has initiated discussions with the Province of BC on the certificate renewal process. The Company continues to seek market outlets which would support the development of the quarry to produce crushed rock construction aggregate products. This high quality aggregate is anticipated to be ideal for asphalt manufacture and over time is expected to be a significant source of coarse aggregate for use in concrete when it will complement Orca Quarry which produces a high proportion of natural sand. The effects of the recession have made it difficult to predict when it might be possible to advance this project to a construction phase.

### ***Marine Terminals***

The Company is still at a relatively early stage of development of its marine receiving terminals despite having commenced production in 2007. Opportunities to develop suitable marine terminals are scarce and access, whether through owned and operated or third party facilities, is a key component in the logistical chain. The Company currently delivers construction aggregate to five terminals in San Francisco Bay where it is now the exclusive supplier by ocean-going vessel. The Richmond Terminal, owned and operated by the Company, has a permitted capacity of 1.5 million tons per year and serves the north and east Bay areas. The Redwood City terminal in southwest San Francisco Bay and the Pier 92 terminal near downtown San Francisco are owned and operated by the Company's strategic alliance partner, Cemex, with a combined annual capacity of well over 1.5 million tons. Since February, 2013, the Company has also supplied the Pier 94 terminal of Hanson Aggregates in the Port of San Francisco. The Landing Way Depot, on the Petaluma River in Sonoma County, owned and operated by Landing Way Depot, Inc., has an annual capacity of approximately 1.25 million tons and serves the requirements of Shamrock Materials Inc.

The Company's strategic objectives include the development of marine terminals in southern California. In the third quarter of 2009, the Company secured an option to lease an existing marine aggregate importing terminal in the Port of Long Beach, California, at Berth D-44 and, in July 2010, exercised this option and entered into a five year lease with renewal at the Company's option for a further three, five-year, periods to a total of 20 years. This 8.3 acre site is privately owned and operated for many years receiving construction aggregates from barges with storage in open stockpiles. The site, which was permitted to receive and distribute up to 3 million tons of construction aggregates per year, is located on a deep-water channel and is close to Interstate 710, which services the greater Los Angeles area. The Los Angeles market is now exhibiting strong recovery and following enquiries from major contractors experienced in the use of Orca aggregates, the Company has decided to proceed with the development of the terminal and anticipates first deliveries during the third quarter of 2014 providing final building permit approval is received in a timely manner. The capital cost of bringing this terminal into operation is estimated at \$4 million.

Previously aggregates were delivered by barges and the Company has now received a Harbor Development Permit for the site to enable delivery by Panamax size vessels and is in the process of applying for an Air Board Permit. The Ports of Long Beach and Los Angeles are currently engaged in major construction projects designed to enhance their ability to receive and efficiently handle much larger container vessels. As a consequence, the demand for concrete aggregate to meet these massive construction projects will increase significantly. During the second quarter of 2013 the Company received a dredging permit from the US Army Corps of Engineers for the maintenance dredging required at Berth D-44 in order to accommodate the Panamax vessels of CSL and, following a procedural delay, this work was carried out in March, 2014. The Company has appointed Richard A. Williams as Director Business Development for its US marketing and distribution. Mr. Williams is an experienced concrete engineer and marketing professional based in the greater Los Angeles area who will provide technical expertise in design for projects where the premium quality of the Orca Quarry sand and gravel can offer cost effective solutions. Additionally, the Company placed orders in the current quarter for significant conveying and stacking equipment related to the terminal, along with berthing equipment to be used for mooring vessels at the site.

The Company, through its jointly owned subsidiary company, Cemera San Diego, LLC, remains interested in an opportunity in the Port of San Diego for the development of a marine aggregate terminal to service the San Diego market, which has significant aggregate supply deficiencies. On August 4, 2009, The Port of San Diego granted Cemera San Diego, LLC, an exclusive negotiating agreement (the "ENA") for an option to lease and develop an approximate 100,000 square foot building located at the Tenth Avenue Marine Terminal for the purpose of receiving and distributing aggregates. On February 28, 2010, the ENA expired; however, the Port of San Diego issued a comfort letter in succession to the ENA and the parties continue to negotiate in good faith to agree on the terms of the option to lease. The Company maintains its relationship with this port and is reviewing marketing and development



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possibilities while recognizing that environmental and community issues at this location are complex and it is increasingly difficult to predict what the eventual outcome may be. The Company has maintained an interest in the Port of Hueneme to the north of Los Angeles. The opportunity to develop a terminal in this location, where coarse aggregate supply shortages have been identified, could be of significant interest.

## **SHIPPING**

The Company is currently shipping its products from Vancouver Island, British Columbia, to San Francisco Bay by self-unloading Panamax vessels provided by CSL International Inc ("CSL"). Sales to Hawaii, Alaska, British Columbia, and under the supply agreement to California that commenced in the first quarter of 2013, are made on an FOB, basis by loading ships or barges provided and paid for, by the customer.

On arrival in San Francisco Bay, CSL's vessels are partially unloaded while at anchor ("lightered") into barges provided by Shamrock Materials Inc. under the terms of a twenty-year aggregate supply agreement, or onto a barge operated by an independent towing contractor on behalf of Cemex. Occasionally barge capacity is provided by Hanson Aggregates. After lightering, the balance of the cargo may be unloaded at Cemex's Redwood City terminal or at the Company's Richmond Terminal. These arrangements offer the most economic shipping solution by utilizing fully loaded Panamax vessels from Vancouver Island to San Francisco Bay. The increasing demand for Orca Quarry products in northern California, that now exceeds the level experienced during 2008, assists in maximizing shipping efficiency although balance between the individual terminals requires careful planning.

### **Shipping Fuel Surcharges**

As a consequence of the Company's two major supply agreements in northern California, the Company absorbs changes in the cost of shipping fuel during a quarter and then passes the cost, or benefit, through to the customer during the following quarter. The commencement selling prices to both customers reflected actual fuel costs at the time of entering into the contracts.

The Company's sensitivity to changes in fuel prices is as follows: for every \$10 movement per metric tonne in the price of Low Sulphur Fuel Oil ("LSFO"), the main fuel required to be used in shipping since August, 2012, the Company's delivered price is impacted, positively or negatively, by approximately 3.7 cents per ton.

### **North American Emission Control Area**

On August 1, 2012, the USA EPA and Environment Canada established a North American Emission Control Area (the "ECA") of 200 nautical miles around the US and Canadian coasts. All vessels operating within the ECA must now use Low Sulphur Fuel Oil (LSFO) which has a limit of 1% sulphur. This action significantly increased the cost of shipping from August 1<sup>st</sup>, 2012, which the Company has now passed on to its customers through oil pass-through clauses in the Company's sales agreements.

The objective of the ECA is to reduce emissions from ships that might be harmful to coastal environments, a principle supported by marine cargo shippers including CSL International, the Company's exclusive shipper. However, the US EPA directed that the ECA be 200 miles offshore without the benefit of new research which clearly establishes that an ECA limit beyond 50 miles provides no further benefit to coastal environments. This new regulation has adversely impacted many freight movements in North America and these coastal regions would actually be seriously impacted by the increased air pollution and road congestion that would arise should millions of tons per annum of products, including construction aggregate, be forced to use shore-based truck or rail transportation rather than ships. A Coalition of Short-Sea Shippers, coupled with the Maritime Industrial Transportation Alliance, are actively pressing for the ECA to be modified to 50 miles for smaller, short-sea, coastal vessels which would include those operated by CSL. The Company is engaged with the National Stone and Sand and Gravel Association to support the coastal shippers in achieving a modification to the ECA regulations thus enabling the current economic benefits to be maintained in the vital supply of construction aggregates to coastal cities, without negatively impacting the coastal environment.

## **CUSTOMERS**

The Company's Strategic Alliance with Cemex, which was established in 2007, provides for the joint development of new port receiving terminals on the US west coast that will ultimately be required to achieve the Orca Quarry's permitted production of 6.6 million tons per year. Either company may proceed with a legitimate terminal development project should the alliance partner decline the right to participate for any reason. Cemex, a public company,



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headquartered in Mexico, is one of a small number of major international cement manufacturers and a significant producer of construction aggregate and ready mix concrete, in markets throughout the world.

A second long-term supply agreement commenced with Shamrock Materials in 2007. Orca Quarry products are unloaded from Panamax vessels, at anchorage in San Francisco Bay, into Shamrock's own barges for transportation to an aggregate terminal situated at Petaluma, CA. Shamrock Materials is a well-established private company supplying ready mixed concrete in the north San Francisco Bay area.

The Company maintains a close relationship with the management of both Shamrock and Cemex, which together accounted for approximately 73% of the Company's sales in 2013.

In December 2012, the Company entered into a sales agreement with Hanson Aggregates Mid-Pacific Inc., a subsidiary of a major international building materials company headquartered in Germany. The agreement has a fixed first period of three years with two, three-year, renewal options requiring mutual agreement to extend. Sales under the agreement commenced in February, 2013.

The Company also supplies customers in Hawaii and British Columbia, which are substantial private companies with whom management maintains a working relationship.

### **SALES AND SEASONALITY**

The Company's Orca sand and gravel quarry operates year-round, however, sales demand is seasonal due to the impact of poor weather conditions, particularly in the first (winter) quarter which have an impact on production volumes and demand for the Company's products. As a consequence the Company's financial results for any individual quarter are not necessarily indicative of results to be expected for that year. Sales and earnings are typically sensitive to regional and local weather, market conditions, and, in particular, to cyclical variations in construction spending.

### **Related Party Transactions**

During the three months ended March 31, 2014, the Company accrued for or paid the following services by related parties. Proconsult UK Ltd. ("Proconsult"), a company controlled by a director of subsidiary of the Company, provided to the Company, management and marketing services at a cost of \$48,149 (three months ended March 31, 2013 - \$87,549). The Company has an agreement to pay Proconsult a retainer of \$14,500 per month plus expenses until June 30, 2014 when the agreement terminates. Navigator Management Ltd. ("Navigator"), a company controlled by a director of the Company, provided to the Company, consulting services at a cost of CAD\$9,000 (three months ended March 31, 2013 - CAD\$9,901). The Company has agreed to pay Navigator a retainer of CAD\$3,000 per month.

These costs are included in general and administrative expenses. Transactions with related parties are recorded at the price agreed between the parties.

At March 31, 2014, accounts payable included; \$14,500 due to Proconsult, (December 31, 2013 - \$19,252) and CAD\$3,000 due to Navigator, (December 31, 2013 - CAD\$3,850).

### **Significant accounting judgments and estimates**

The Company's accounting policies are described in Note 3 to the December 31, 2013 audited consolidated financial statements. The preparation of financial statements requires management to use judgment in applying its accounting policies and estimates and assumptions about the future. Estimates and other judgments are continuously evaluated and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. The Company considers the accounting policies and estimates for; the determination of mineral reserves, asset values and impairment charges, estimated reclamation, closure costs, and provision for property tax assessment, to be significant. There is a full discussion and description of the Company's significant accounting judgments and estimates in the 2013 management discussion and analysis.



(US dollars, except where noted)

(Unit of weight is US short tons)

## Financial Instruments

Cash, trade receivables, security deposits and other receivables are classified as loans and receivables. Trade payables are classified as other financial liabilities. Financial instruments that are classified as loans and receivables and other financial liabilities are measured at amortized cost.

The Company does not measure any financial instruments or other assets at fair value on a recurring basis in the statement of financial position. The fair values of cash, trade receivables, security deposits, other receivables, and trade payables, approximate their carrying values due to either their short-term nature or maturities.

## Capital Stock

As at the date of this report, the Company had unlimited common shares authorized, of which 80,549,414 were issued and outstanding. The Company also has 3,801,709 options outstanding, exercisable into 3,801,709 common shares, of which 2,861,709 are currently vested, and 807,438 warrants outstanding, all of which are vested.

## Risks and Uncertainties

The development and operation of the Company's construction aggregate properties involves a high degree of business and financial risk. Accordingly, investment in the securities of the Company involves a high degree of risk and should be regarded as speculative due to the nature of the Company's business. The Company has incurred losses and expects to incur further losses. The following risks are not intended to be a complete list of all risk factors or presented in any assumed order of priority. A full discussion and description of the Company's risks which should be taken into account in assessing important factors that could cause the Company's actual results to differ materially from the Company's expectations are disclosed under the heading "Risks and Uncertainties" in the Company's 2013 Management Discussion and Analysis and under the heading "Risk Factors" in the Company's Annual Information Form (AIF) in respect of its financial year ended December 31, 2013, both of which are filed with Canadian regulators on SEDAR ([www.sedar.com](http://www.sedar.com)). Any one or more of the following risks could have a material effect on the Company.

### **The Company's operations will require further capital**

The quarrying, processing and development of the Company's properties and terminals, including the property at Berth D-44 in the Port of Long Beach and any future terminals which may be acquired and developed by the Company will require substantial additional financing. Failure to obtain sufficient financing may result in delaying or indefinite postponement of development or production of the Company's properties and terminals or even a loss of those property interests. There can be no assurance that additional capital or other types of financing will be available if needed or that, if available, the terms of such financing will be favourable to the Company. Any future financing may be dilutive to existing shareholders.

### **Current global financial conditions**

Current global financial conditions have been subject to increased volatility. These factors may impact the ability of the Company to obtain equity or debt financing in the future and, if obtained, on terms favourable to the Company. If these increased levels of volatility and market turmoil continue, the Company's operations and the value and price of the Common Shares could be adversely affected.

### **Reliance on Certain Customers**

The Company generates the major proportion of its revenue from sales to three customers. The ability of these customers to continue in business could have a material effect on the Company and no assurance can be given in that respect.

### **The Company may not secure additional construction aggregates sales volumes and prices projected for the Orca Quarry**

The value and price of the Common Shares, the Company's financial results, and the Company's development and quarrying activities may be significantly adversely affected if the Company does not secure the sales volumes and prices of construction aggregates intended for the Orca Quarry. Demand for construction aggregates products in the Company's target markets fluctuates and is affected by numerous factors beyond the Company's control such as private sector residential and commercial construction, and public sector construction, including roads, bridges,



(US dollars, except where noted)

(Unit of weight is US short tons)

services, and other infrastructure. The supply of construction aggregates to the Company's target markets may also fluctuate and may be affected by new or expanded local production, or supplies of construction aggregates brought into the target markets by road, rail or vessel. Depending on the sales volumes and prices of construction aggregates, cash flow from quarrying operations may not be sufficient and the Company could be forced to discontinue production and may lose its interest in, or may be forced to sell, some or all of its properties. Future production from the Company's Orca Quarry is dependent on applicable construction aggregates sales volumes and prices being sufficient to make materials extraction from the Orca Quarry economic.

In addition to adversely affecting the Company's financial condition, declining construction aggregates sales volumes and prices can impact operations by requiring a reassessment of the feasibility of the Orca Quarry. Such a reassessment may be the result of a management decision or may be required under financing arrangements related to the Orca Quarry. The need to conduct such a reassessment may cause substantial delays or may interrupt operations until the reassessment can be completed.

### **Currency fluctuations may adversely affect the Company's financial performance**

The effects on financial performance and cash flows, of the foreign exchange rate and the escalation of the Canadian dollar against the U.S. dollar are significant. The Company does not currently have any intention to enter into hedging contracts in connection with foreign currencies. The appreciation of the Canadian dollar against the U.S. dollar would increase Canadian dollar costs, due to stronger Canadian dollars being converted into U.S. dollars, and could materially and adversely affect the Company's U.S. dollar-reported operational profitability and financial condition.

### **The Company currently depends on a single property**

The Company's only material mineral producing property is the East Cluxewe Deposit. Unless the Company acquires or develops additional material properties or projects, the Company will be solely dependent upon the operation of the Orca Quarry for its revenue and profits, if any.

### **The Company may not meet minimum freight contract volumes**

The Company's freight contract, which was again amended and restated in December 2013, provides for minimum annual volumes of construction aggregates. If the Company is unable to secure sufficient sales volumes to meet those minimum freight volumes, its revenues, operations and financial condition could be materially adversely affected.

### **Property tax provision**

The Company has received a payment demand from the County Assessor for Contra Costa County for property taxes in respect of the Company's aggregate terminal located in the City of Richmond, California, including penalties, for property tax dating back to 2008, which the Company has appealed. The Company has recorded a provision for its current best estimate of the property taxes owing of \$1.535 million. The estimated liability at March 31, 2014 of \$1.156 million is net of the amount already paid. The amount of the final settlement is uncertain and the provision amount could be subject to change.

### **Eagle Rock Quarry Project Royalty Assessment**

The Company has received a royalty assessment from the British Columbia Ministry of Forests, Lands and Natural Resource Operations for overdue royalties of CAD\$456,000 for 2012 and CAD\$496,000 for 2013, in respect of the Company's quarrying lease for the Eagle Rock Quarry project ("ERQ project") located on the Alberni Inlet to the south of the City of Port Alberni, British Columbia. The Company is disputing the assessment. The Company has not recorded a provision for the royalties. The amount of any payment, if required, is currently uncertain and it may be necessary to record a provision in future periods.

### **Additional risk factors**

Quarrying involves a high degree of risk and the Company has a limited history of construction aggregate project development or operations. Additionally, certain groups are opposed to quarrying and could attempt to interfere with the Company's operations, whether by legal process, regulatory process or otherwise. The Company's title to its properties may be subject to disputes or other claims, including land title claims of First Nations. Construction aggregate quarrying, processing and development activities are highly regulated and changes to government regulations or interpretation of those regulations may also adversely affect the Company. The Company currently depends on a single property with a construction aggregate reserve that has an estimated life at inception of 25 years. Construction aggregate reserves are estimates only and the assumptions made in the AMEC financial



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analysis of the Orca Project may no longer be reasonable. In order to maintain its annual production the Company will be required to obtain other construction aggregate resources in the future to bring into production. The Company's operations are subject to environmental risks and the actual costs of reclamation for the property are uncertain. Further, the Company's insurance will not cover all the potential risks associated with a quarrying operation. The Company is principally dependent upon its key personnel and will also be required to recruit and retain personnel to facilitate the growth of the Company.

## Controls and Procedures

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. Any system of internal control over financial reporting, no matter how well designed, has inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. There have been no changes in the Company's internal control over financial reporting during the three months ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

## Cautionary Note Regarding Forward Looking Statements

This Management's Discussion and Analysis release contains "forward-looking statements" and "forward-looking information" within the meaning of applicable securities laws. These statements and information appear in a number of places in this document and include estimates, forecasts, information and statements as to management's expectations with respect to, among other things the future financial or operating performance of the Company, costs and timing of the development of the construction aggregate quarry, the timing and amount of estimated future production, costs of production, capital and operating expenditures, requirements for additional capital, government regulation of quarrying operations, environmental risks, reclamation expenses, and title disputes. Often, but not always, forward-looking statements and information can be identified by the use of words such as "may", "will", "should", "plans", "expects", "intends", "anticipates", "believes", "budget", and "scheduled" or the negative thereof or variations thereon or similar terminology. Forward-looking statements and information are necessarily based upon a number of estimates and assumptions that, while considered reasonable by management, are inherently subject to significant business, economic and competitive uncertainties and contingencies. Readers are cautioned that any such forward-looking statements and information are not guarantees and there can be no assurance that such statements and information will prove to be accurate and actual results and future events could differ materially from those anticipated in such statements. Important factors that could cause actual results to differ materially from the Company's expectations are disclosed under the heading "Risks and Uncertainties" in the Company's Annual Report and under the heading "Risk Factors" in the Company's Annual Information Form (AIF) in respect of its financial year-ended December 31, 2013, both of which are filed with Canadian regulators on SEDAR ([www.sedar.com](http://www.sedar.com)). The Company expressly disclaims any intention or obligation to update or revise any forward-looking statements and information whether as a result of new information, future events or otherwise. All written and oral forward-looking statements and information attributable to us or persons acting on our behalf are expressly qualified in their entirety by the foregoing cautionary statements.

## Other Information

Additional information related to the Company is available for viewing on SEDAR at [www.sedar.com](http://www.sedar.com) and at the Company's website at [www.polarmin.com](http://www.polarmin.com).

## Glossary of Terms

**Ton** – the unit of weight used in the US consisting of 2,000 imperial pounds, often referred to as a 'Short Ton'.

**Metric Tonne** – a unit of weight commonly used in Canada and worldwide in shipping operations consisting of 1,000 kilograms (2,205 imperial pounds).