

TYPE A WATER LICENSE

2AM-JER1119

Jericho Diamond Mine

QUARTERLY REPORT

For the Quarter Ending: May 31, 2012



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1 INTRODUCTION

This Quarterly Report has been prepared in accordance with Part B, Item 3 of the Type A Water License 2AM-JER1119, issued by the Nunavut Water Board (NWB) on February 7, 2012 to Shear Diamonds (Nunavut) Corp., a wholly owned subsidiary of Shear Diamonds Ltd.

The Quarter being reported on is for the three months ended May 31, 2012. Financial statements for this quarter will be provided in the report for the next quarter, which is in line with the filing requirements of the securities exchange that the Company reports under. The Financial statements for the previous quarter can be found in Appendix A.

2 UPDATE OF COMPLIANCE STATUS WITH THE LICENCE

During the quarter being reported, Shear conducted weekly internal inspections at site. The internal inspection forms are discussed with the Site Manager and action items are developed where needed. The internal inspection form was updated to follow the same format as those used by the Water Resource and Lands Officers during their inspections. Shear attaches the internal inspection reports to the monthly reports that is filed with the Nunavut Water Board and the Inspector.

Spills

During the quarter being reported eighteen (18) spills were reported. These spills were cleaned up, with the exception of the FPK spill where clean up is ongoing. The number of spills may seem high, however, Shear has been documenting and reporting every spill that occurs at site as opposed to following the threshold's listed in the Government of Nunavut's *Spill Planning and Reporting Regulations*. The information that is learned from following up and determining the actual cause of the spill has helped in addressing how to prevent these types of spills from occurring in the future. As a result of these spills, Shear has increased manpower at site, provided refresher training for fuel handling, fuel transfer and spill response, implemented new procedures and improved documentation and record keeping. The spill report numbers are:

- March 4, 2012, 0.3 litres hydraulic fluid
- March 5, 2012, 0.4 litres oil
- March 15, 2012, ~3 litres diesel
- March 17, 2012, ~15 litres diesel
- March 18, 2012, ~5 litres diesel
- March 21, 2012, 7 litres diesel
- March 31, 2012, 3 litres diesel
- 12-116, 10 litres diesel
- 12-121, 800 litres oil
- 12-136, 15 litres waste oil
- 12-148, ~400 litres diesel
- 12-158, ~100 litres diesel
- 12-159, 1 litres hydraulic oil
- 12-169, 15 litres oil
- 12-184, FPK spill
- 12-196, 5 – 10 litres diesel
- 12-201, 100 litres diesel
- 12-217, 40 litres raw sewage

Monthly Reports

Monthly reports were filed on time for each of the months being reported on for this quarter. During this quarter, Shear began attaching the weekly internal inspection reports to the monthly reports. The format of the internal inspection reports follows the format of the AANDC inspection forms.

3 UPDATE DESCRIBING ANY PROPOSED CHANGES TO ANY PLANS

The public hearing was held on November 30 and December 1, 2011 in Kugluktuk. During the public hearing, and in response to the questions raised by interveners and in written submissions, Shear made a number of commitments with regard to revising and updating plans to reflect the comments received.

The renewed water licence was issued effective February 7th, 2012. A number of updated plans are required over the next year. No plans are required during the upcoming quarter. However, secondary containment will be installed at all refuelling areas this summer. The as-built drawings will be submitted and will be included in the revised Contingency Plan.

The following plans were submitted during the quarter being reported:

- QA/QC Plan – April 30, 2011
- Technical Memo: Revised Pit Infill Rates – April 15, 2011
- Status Update and Clarification of the Aquatic Effects Monitoring Plan – April 1, 2012

4 UPDATE WITH RESPECT TO CONSTRUCTION AND PRODUCTION SCHEDULE

- Processing from stockpiles began April 6, 2012.
- Design drawings will be prepared during the month of July for secondary containment of all refueling areas.
- Repairs will be made to the HWTa this summer.
- An irrigation system is being installed in Cell A of the PKCA to wet the FPK.
- Shear plans to re-start commercial production late 2013. Plans for construction and production schedule to be updated quarterly.

5 CORRESPONDENCE WITHIN THE QUARTER WITH REGULATORY AUTHORITIES

The following summarizes the correspondence with regulatory authorities for the quarter being reported.

March 2012

- March 2, 2012 – Email from Eva Paul (AANDC) to Kyle Conway (Shear) notifying of a planned site inspection proposed for March 20, 2012.
- March 6, 2012 – Letter to Eva Paul (AANDC) regarding the additional security required under the renewed water licence.
- March 8, 2012 – Letter from Andrew Keim (AANDC) in response to the March 6, 2012 letter submitted by Shear.
- March 31, 2012 – Annual Report Submitted to Nunavut Water Board.

April 2012

- April 13, 2012 – Quarterly Report Submitted to Nunavut Water Board.
- April 16, 2012 – Letter to Nunavut Water Board providing an update to the Aquatic Effects Monitoring Program.
- April 18, 2012 – Email to NWB with attachment, Technical Memo K – Pit Filling Rate Estimation Update.
- April 23, 2012 – Email with attachment to the AANDC Analyst – QA/QC Plan for the Jericho Diamond Mine.
- April 25, 2012 – Letter from Andrew Keim (AANDC) regarding the additional security required under the renewed water licence.
- April 30, 2012 – Email with attachment to the NWB – QA/QC Plan.

May 2012

- May 13, 2012 – FPK Spill Report along with appendices– sent to distribution list.
- May 15, 2012 – Email to distribution list providing update on the FPK issue.
- May 17, 2012 – Email to distribution list providing further update on the FPK issue.
- May 18, 2012 – Email to Eva Paul (AANDC) regarding Phase II Fuel Farm clean up action plan.
- May 23, 2012 – Email to distribution list providing update on the FPK clean up activities.