RBC Capital Markets

RBC Europe Limited
Des Kilalea (Analyst)
+44 20 7653 4538
des.kilalea@rbccm.com

Richard Hatch, ACA
(Associate)
+44 20 7002 2111
richard.hatch@rbccm.com

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Lucara Diamond Corp.

New Diamond Miner in a Stable Country

Our View: We are initiating coverage of Lucara Diamond Corp, a company already in production in Botswana, with a recommendation of Outperform and a Price Target of C$1.05/sh.

Key Points:

One of the few diamond miners: Lucara has joined the small universe of producers by opening the Karowe mine in Botswana, one of the more stable environments globally to operate a diamond mine. Karowe sells rough diamonds into a market where the supply and demand outlook suggests good underpinning for diamond prices, given limited new production, solid US demand, and good jewellery potential in Asia. Management expects production to average nearly 400,000 ct a year for the next 15 years at least in a country, Botswana, which is rated as one of the more stable globally for miners.

Balance sheet boost from large stones: Recent diamond sales and the recovery of large stones at the Karowe mine in Botswana have also bolstered Lucara's balance sheet such that it will be in a position to look for expansion opportunities and, we believe, become a dividend payer, perhaps in 2015 if M&A or exploration opportunities do not present themselves.

Mothae project has a way to go: Lucara owns 75% of the Mothae project in Lesotho. We include only a small value on this asset because it will need much higher diamond prices to become economic, or a deal with a nearby producer, in our view. Neither seems likely at present, but in time, we view a project as a realistic possibility.

Lower risk aids valuation: We valued Lucara using a DCF (8%) model of Karowe, which results in a $382 million valuation, and a notional $50 million value for Mothae. Our Operating NAV totals $432 million; our final Net Asset Value is $374 million (C$1.02/sh).

Investment Conclusion

We have visited Karowe several times in the past six years as it was developed into a producing mine. Management, which with the directors own ~20% of the equity, brought the mine in on time and within budget and Karowe's cash flow has been boosted by the discovery of large stones; this will enable Lucara to redeem the $50 million debenture issued to develop the mine ahead of time, we believe. Unless M&A, which we would favour, or exploration absorbs the free cash flow, we see the potential for dividend payments by end-2015. We initiate with a recommendation of Outperform and a Price Target of C$1.05.

Outperform

TSX: LUC; CAD 0.89

Price Target CAD 1.05

Scenario Analysis*

Downside Scenario	Current Price	Price Target	Upside Scenario
0.50	0.89	1.05	1.60
↓ 44%		↑ 18%	↑ 80%

*Implied Total Returns

Key Statistics

Shares O/S (MM):	376.3	Market Cap (MM):	335
Dividend:	0.00	Yield:	0.0%
NAVPS:	1.02	P/NAVPS:	0.9x

Management currently own ~20% of the outstanding shares.

RBC Estimates

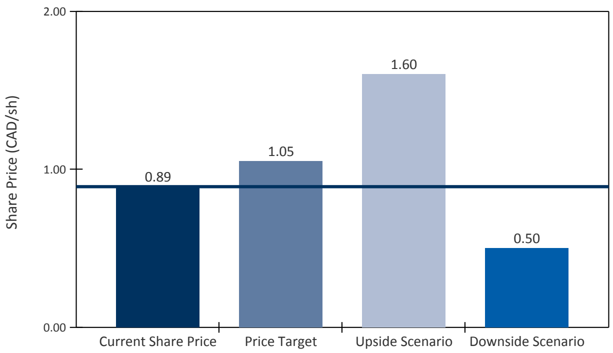
FY Dec	2012A	2013E	2014E	2015E
Revenue (MM)	41.8	116.3	131.5	150.7
EBITDA (MM)	(0.2)	37.0	47.2	69.6
EPS (Op) - Basic	(0.02)	0.04	0.08	0.14
Margin	(0.5)%	31.8%	35.9%	46.2%
P/E	NM	21.9x	10.9x	6.2x

Revenue (MM)	Q1	Q2	Q3	Q4
2012	0.0A	0.0A	12.7A	29.2A
2013	32.5A	31.4E	26.2E	26.2E
2014	32.9E	32.9E	32.9E	32.9E

All market data in CAD; all financial data in USD.

Target/Upside/Downside Scenarios

Exhibit 1: Lucara Diamond Corp.



Source: RBC Capital Markets estimates

Target Price/ Base Case

Our Lucara Price Target of C$1.05/sh is based on a blend of 1x NAV and 10x an average of 2014E and 2015E earnings. Our NAV is based on a DCF (8%) model of Karowe plus a $50 million valuation for Mothae. The key to using our higher price:NAV multiple than for some of the other companies under coverage is that there is no project risk at present and that the company is moving into a position where it should be able to consider paying dividends. Our Price Target is C$1.05/sh and our recommendation is Outperform.

Upside Scenario

Our upside scenario of C$1.60/sh is based on the same blend of 1x NAV and 10x an average of 2014E and 2015E earnings. For an upside scenario, we assumed that the global economy grows at a larger than forecasted rate and retail demand for diamonds picks up, driven by Chinese and Indian growth, coupled with strong continued demand from core markets such as the US and Japan. We also assume opex savings improve.

Downside Scenario

Our downside scenario valuation of C$0.50/sh is based on the same blend of 1x NAV and 10x an average of 2014E and 2015E earnings. For a downside scenario, we assumed that the growth and sentiment within the global economy weakens, which may have a subsequent effect on rough diamond prices. We, therefore, modelled rough prices down by 10%. In addition, we assume an increase in opex pressures of nearly 10% to reflect cost inflation.

Investment Thesis

We believe that Karowe is a strong asset with the capacity to produce above average stones which are enhancing value; this will provide a foundation for paying down debt and potentially paying dividends. Our positive view is supported by our view on the diamond market - while world growth remains somewhat sluggish, growth in demand for diamond jewellery should be relatively firm in the Asian markets, primarily China. In addition, the US market, which is the bedrock of demand and accounts for 35% to 40% of global diamond jewellery sales, is starting to recover. Add to this a dearth of new diamond mining projects, and we see relatively good underpinning for rough diamond prices. Lucara's Karowe mine should capitalize on what appears to be good underlying fundamentals for the miners in the medium term.

Potential Catalysts for the stock

- **Large and exceptional tender:** Should mining in the balance of H1 and H2 be as successful as H1, the company could hold a second large and exceptional stone tender. The tender held in H1 raised $25 million ($30,468/ct).
- **M&A:** With Mothae on care and maintenance until prices pick up and costs reduce, Lucara would need to seek external opportunities to grow production. We would expect the company to seek late-stage exploration or development assets.
- **Economic growth:** Stronger than expected economic growth (particularly from polished diamond demand growth areas such as India and China) could positively affect our thesis.

Risks to our investment thesis

- **Weaker grades:** Since the beginning of operations, Karowe has experienced stronger than forecasted grades. Missing the revised production target of 420,000 ct would be negative, in our view.
- **Opex inflation:** When Lucara ends its contract mining period in 2014, costs are expected to improve from $23/t. However, any increases to costs could negatively affect our valuation.
- **Economic growth:** Slower than expected economic growth (particularly from polished diamond demand growth areas such as India and China) could negatively affect our thesis.

Des Kilalea +44 20 7653 4538; des.kilalea@rbccm.com

Key Questions

	Our View
1. What is the likelihood of continued recovery of large stones?	The large stones were recovered from the centre lobe; mining continues here but there is a risk that this trend does not continue. We will look to Q2 and Q3 results for a continuation of the trend.
2. What is the likelihood of a second large and exceptional tender?	Lucara has had a particularly strong start to operations at Karowe, with the recovery of some very valuable stones, which were unexpected. Mining continues in the Centre lobe, and should the recent track record of 84 diamonds over 10.8ct being recovered in a six-week period, we would expect to see a second large and exceptional tender in H2.
3. What are the options for Mothae?	The Mothae mine is located in a challenging geographical location (northeast Lesotho) where power availability and water access are scarce. With currently weak pricing in the large rough market, Mothae needs stronger pricing to become economically viable. Similarly, power and water need to become available at a less prohibitive cost. In the near term, we see limited development options, and expect the asset to remain on care and maintenance (nearly $75,000/month). In the longer term, we could see a potential partnership with another diamond producer.
4. Is M&A on the agenda?	Lucara is in an attractive position of having a strong balance sheet (minimal debt and increasing cash reserves). However, with Mothae on care and maintenance in light of lower rough prices and high costs, production is currently constrained at nearly 400,000ctpa. Rather than acquire or merge with a producer, we could see Lucara use its strong project management skills acquired at Karowe to acquire a late-stage exploration or perhaps development asset; we would expect it to remain in the African geography.
5. What will Lukas Lundin do with his 15% holding?	We would expect chairman and significant shareholder Lukas Lundin to continue holding his investment in Lucara. Management expects him to remain a cornerstone investor in the company.
6. Will the Phase 2 expansion to 4mt go ahead?	We believe that it is unlikely that the $36 million Phase 2 expansion (which would take ore throughput to 4.0mt from 2.5mt) will be approved given higher capital intensity, which would require significant capex in 2014 and 2015. We expect the company to run the plant at 2.5mtpa and extend the mine life by around four years.
7. What is the outlook for diamond pricing?	The long-term fundamentals of the diamond market remain strong given improving demand in polished goods (driven by continued US strength, and further Indian, Chinese, and other Asian growth) and constraining supply as existing mines deplete their reserves, delays in development projects, and a lack of new kimberlite discoveries. Lucara is well placed in this regard given the recovery of large white and rare blue stones, which demand a market premium.

Lucara Diamond Corp – Initiating with Outperform

Investment Thesis

We are initiating coverage on Lucara Diamond Corp with an Outperform recommendation and a Price Target of C$1.05. Our valuation is based on a DCF (8%) model for the company's 100%-owned Karowe diamond mine in Botswana (giving a value of $382 million) and a notional amount ($50 million) for its Mothae development project in Lesotho.

The investment attraction of Lucara is the Karowe mine in Botswana, which was developed on time and within budget, and is now producing at an annual rate of ~400k ct/year. The mine's cost base is relatively low and the profit margin has recently been boosted by the recovery of large diamonds which had not been in the mine plan. In May Lucara sold 15 stones for a total of $24.85m, or $30,468/ct. While the continued recovery of large fine diamonds cannot be predicted, our view is that for the balance of this year, at least, further higher-valued diamonds are likely to be recovered.

While world growth remains somewhat sluggish at present, growth in demand for diamond jewellery should be relatively firm in the Asian markets, primarily China. In addition, the US market, which is the bedrock of demand and accounts for 35–40% of global diamond jewellery sales, is starting to recover. Add to this a dearth of new diamond mining projects, and we see relatively good underpinning for rough diamond prices.

Exhibit 2: RBC valuation and price target ($ millions, except per share data)

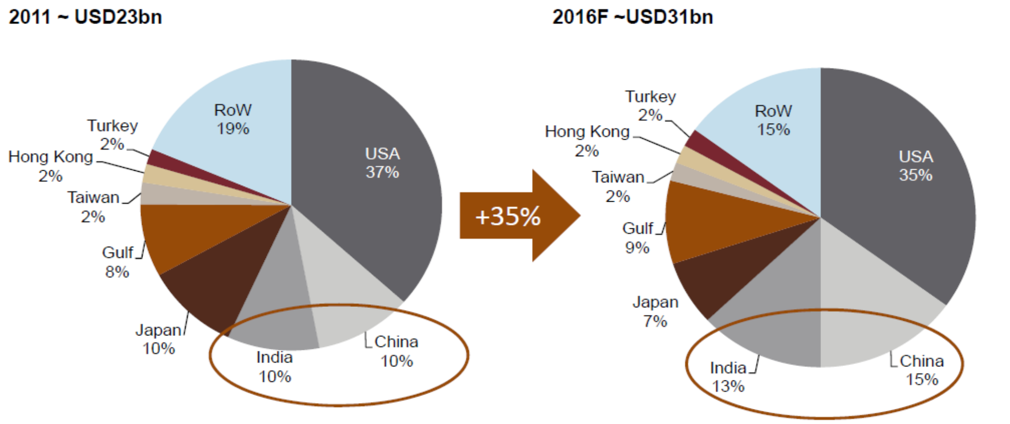
Net Asset Value @ 8%	2013E	2014E	2015E
Karowe (100%)	$382	$370	$346
Mothae (75%)	$50	$50	$50
Operating NAV	$432	$420	$396
Corporate Adjustments	($58)	($55)	($53)
Net Asset Value	$374	$365	$343
Shares Out (Basic)	375	376	376
NAV Per Share (US$)	**$1.00**	**$0.97**	**$0.91**
NAV Per Share (CAD)	**C$1.02**	**C$0.99**	**C$0.93**
Target price (CAD)	**C$1.05**		

Source: Company reports and RBC Capital Markets' estimates

Lucara's Karowe mine should capitalize on what promises to be good underlying fundamentals for the miners in the medium term. In addition, the mine has recently been producing some large high-colour diamonds, which had not been anticipated in the initial mine model. This is enhancing average rough stone values.

Lucara has joined the small list of listed diamond-only producers (Dominion Diamonds, Petra Diamonds, and Gem Diamonds in the main). The appearance of large diamonds has strengthened the balance sheet. We believe the underlying value of the company firmly underpins our recommendation.

Exhibit 3: Global diamond jewellery sales

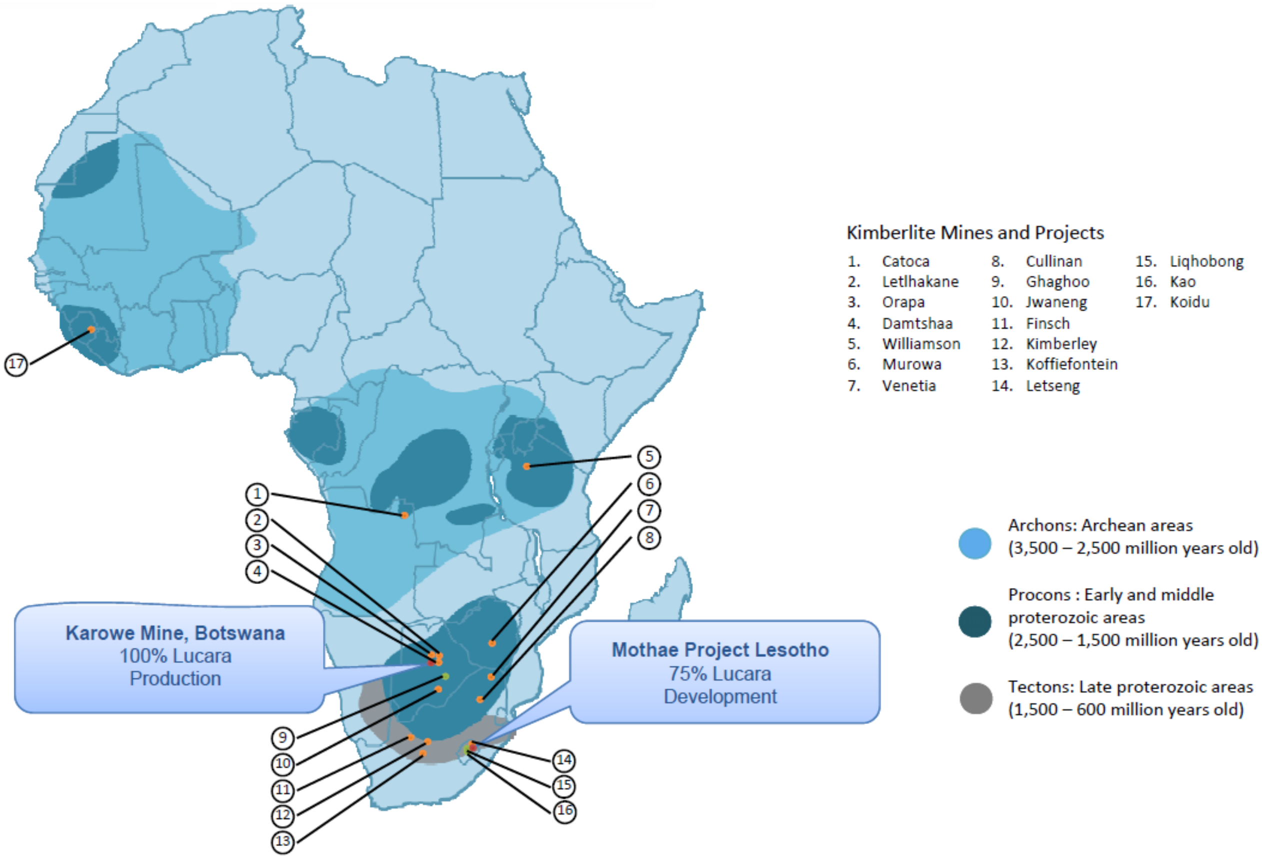


Source: De Beers,

History

Lucara's initial focus in the diamond sector was on the Mothae kimberlite project in Lesotho, which was acquired firstly through a joint venture, and finally the acquisition of Canadian-listed Motapa Diamonds. Lucara acquired an initial 70.268% interest in the Karowe mine from De Beers in November 2009 for $49 million. The balance was held by African Diamonds (28.381%) and Wati Ventures (1.351%). As part of the initial acquisition, African Diamonds had a call option to acquire a further 10.268% in Karowe for $7 million plus interest; in April 2010, this was completed along with the acquisition of Wati's 1.351% stake. Subsequent to this transaction, Lucara held 60% and African Diamonds held 40%. Lucara increased its holding to 100% of the mine in December 2010 when it acquired African Diamonds in an all-share deal valuing its 40% stake at C$72 million. African Diamonds' other exploration assets are now housed in AIM-listed Botswana Diamonds (not covered). Lucara listed on the Botswana exchange in July 2011 and in Stockholm in November 2011. Production from the Karowe mine started in Q1/12 with commercial production declared on July 1 2012.

Exhibit 4: Location of Lucara assets and other kimberlites



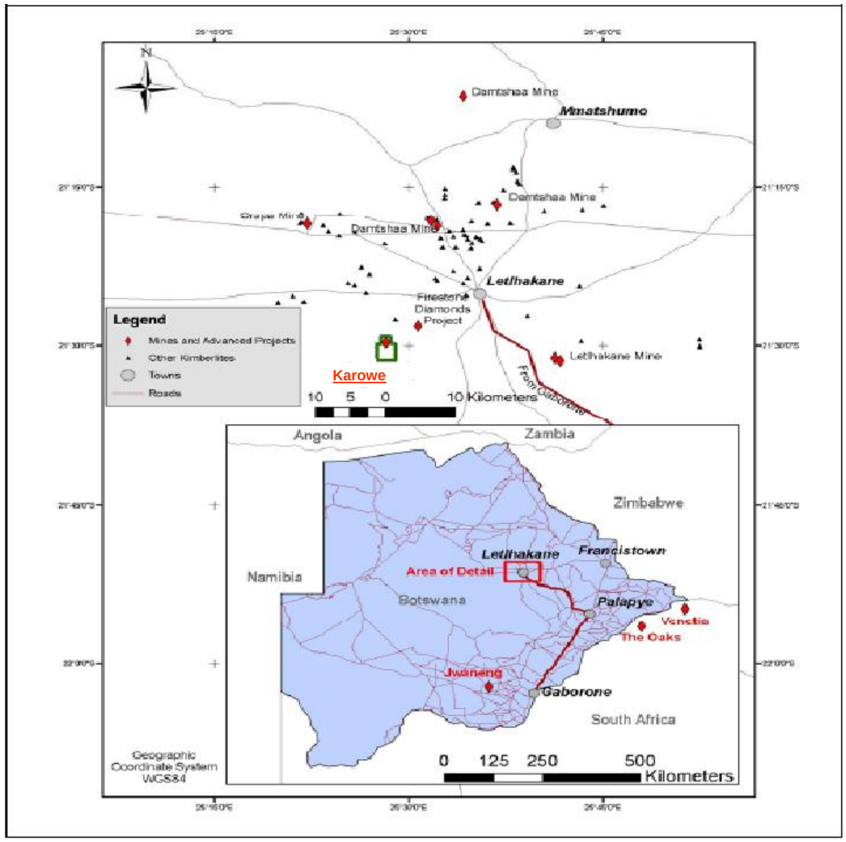
Source: Company reports

The Assets

Karowe is the star asset

While Mothae was the founding asset, the Karowe Mine (AK6 kimberlite) is now the principle source of value in the company. Karowe is situated in Botswana near the large Orapa Mine run by De Beers associate Debswana, which produced 12.1 million carats in 2012 valued at nearly $950 million. Other mines in the area include Debswana's Letlhakane and Damtshaa's open-pit operations. Firestone Diamonds' BK11 project, which is on care and maintenance, is also in the Orapa area.

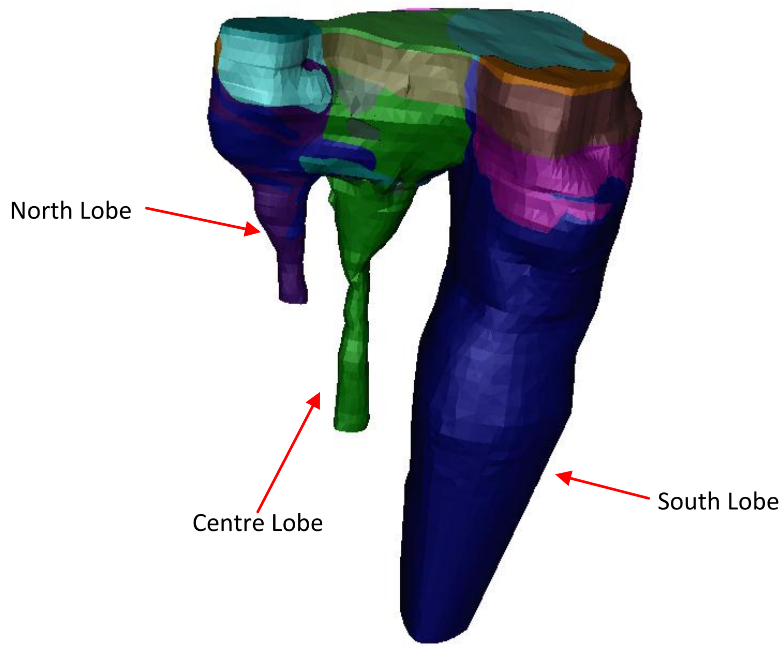
Exhibit 5: Location of Karowe mine



Source: Company reports

The Karowe ore body comprises three lobes—North, Central, and South—which coalesce at surface with an area of 4.2 hectares that expands to 7 hectares at a depth of 120 metres. The North and Central lobes are similar geologically while the South is harder. At depths below 120 metres, the three ore bodies split into three tapering pipes with the bulk of the volume in the South. From the surface to 400 metres depth (the base of the indicated resource defined by De Beers), the South lobe comprises 72% of the volume of ore.

Exhibit 6: Geological model of the AK6 kimberlite



Source: Company reports

Following the acquisition of AK6 from De Beers and African Diamonds, Lucara revised the capex estimated to build the mine to $120 million. The more than 15-year mine plan of 2.5mtpa producing 400,000–425,000 ct a year was based on a proven and probable resource from surface to a depth of 324 metres (36.2mt containing 6.3m cts at a +1.5mm cut-off). The feasibility study envisaged a shorter life of mine with an expansion to 4mtpa from 2.5mtpa in the fifth year at a cost of $36.1 million. Management now believes the value proposition is best served by staying with a longer-life smaller mine.

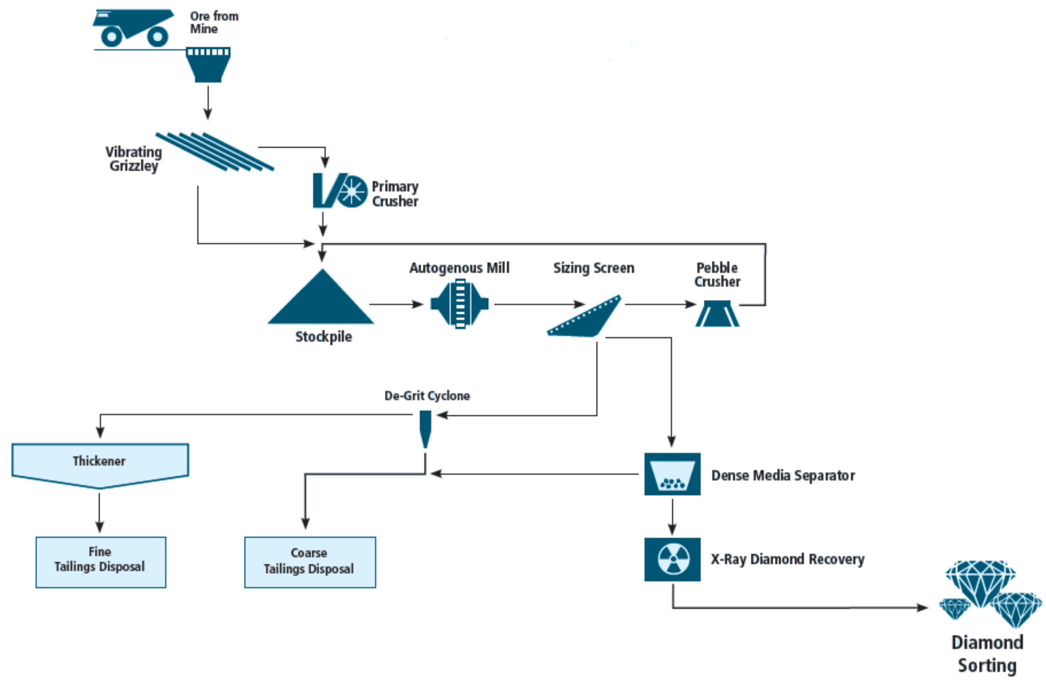
Exhibit 7: Karowe resource statement

Class	Lobe	Tonnes (000)	Grade (cpht)	Carats (000)	$/ct	Value ($m)
	Centre/North	11100	20	2268	276	625.1
INDICATED to 400 metres - (+1.5mm)	South	40128	15	6088	231	1404.3
	TOTAL	**51228**	**16**	**8356**	**194**	**2029.4**
INFERRED from 400 -750 metres	Centre/North	208	20	42	223	9.3
	South	20771	19	3946	183	722.2
	TOTAL	**20979**	**19**	**3988**	**183**	**731.5**

Source: Company reports at date of resource statement

Unlike most of the recent small mine developments, delivery of the Karowe mine was on budget and, had it not been for delays caused by a steel industry strike in South Africa, would have been on time. Production began in April 2012, aided by a stockpile of 280,000t of ore. Operations started on the North lobe with stripping of the Centre and South lobes. Through this year, ore processed during Q1 came from the North lobe with the majority of the ore for the balance of the year sourced from the Centre lobe. Stripping of waste in the Central and South lobes continues to access deeper ore in the North lobe (strip ratio 2.2x).

Exhibit 8: Karowe flow sheet



Source: Company reports

The mine layout sees open-pit ore delivered to the primary crusher from where it feeds the autogenous mill (see Exhibit 9) before sizing into three products. Coarse material is directed to the pebble crusher, which then reports back to the mill after crushing. Intermediate material (-35+1.5mm) reports to the Dense Media Separation plant (DMS), with the concentrate treated using X-ray sorting in final recovery. Subsequent to the discovery of an unbroken 239ct stone earlier this year, the top-size in the process was increased to 35mm from 30mm to improve prospects of recovering large stones unbroken. That the kimberlites may host larger diamonds was always possible after the initial bulk sample produced a parcel of rough which included some larger gems which had been broke in the large diameter drilling (LDD).

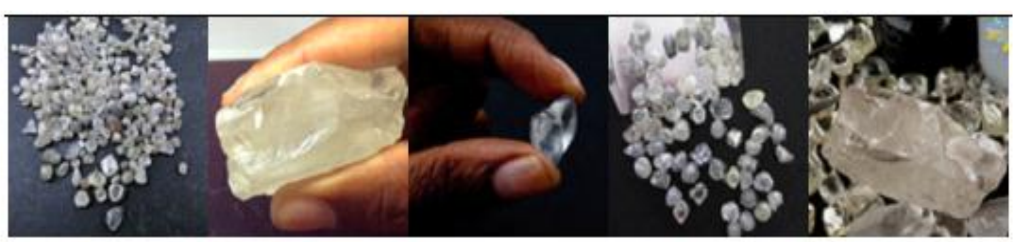
Exhibit 9: Autogenous mill and crushed ore stockpile

Source: Company reports

In 2012, the mill processed 1.4mt of ore, producing 303,000cts, which was 12% ahead of forecast, with an average grade of 22 carats per 100 tonnes (cpht). In Q1 this year the mine's production has increased to 123kct, while average values have also been boosted by the way in which the company sells the rough and by the recovery of large stones. Lucara sells the diamonds on tender with showings now in Gaborone (Botswana) and Antwerp. In our opinion, showing the parcels in Antwerp is one of the contributing factors to rising prices for run-of-mine goods, since the goods are easier for potential bidders to view in Antwerp rather than Botswana.

An unexpected, and welcomed, feature of the Karowe production has been the occurrence of special stones, including some blue diamonds. To date in 2013, the mine produced sufficient specials to hold a separate 'large and exceptional stones' tender in Antwerp during May, which realised $24.8 million ($30,468/ct). This was in addition to the $1.6 million received for the second blue stone (4.77ct) sold in March 2013. A 9.46ct blue stone fetched $4.5 million last October. The 15 diamonds in the large-stone tender included a 239ct white as well as several high-colour whites ranging from 14ct to 124ct—all were recovered in a single production cycle. Since then, several further large stones have been recovered, so a second 'large' tender is being considered for later this year in Antwerp.

Exhibit 10: Some of the Karowe 'specials' including the 239ct white



Source: Company reports

While management is not predicting a continuation of the recovery of special stones (several small blues have also been produced), as mining moves from the current operating areas, the potential this year has led to increased guidance for FY2013. Sales guidance has been shifted 5% higher to 420,000 cts in 2013 and revenues of almost $118 million thereby giving an average price of $281/ct; this excludes the potential from the planned second 'large' tender.

Operating costs are guided to an unchanged $23/t, which compared with company forecast revenue of $47/t. Capex guidance for 2013 has been increased to $5 million from $3 million, mostly on the tailings dam and providing water from additional boreholes.

The future for Karowe

With the plant now running in steady state, the life of mine should extend to at least 2025 or 2026. In the first two to three years of operation, ore will be sourced from the Central and North lobes, with the South kicking in as the major source of ore from year three. As operations move from the North to the South lobe, grade and diamond values are expected to fall (see the resource statement in Exhibit 7); rock hardness in the South also increases to some extent though not such that management envisages any liberation issues. Prospects of life beyond the stated reserve will depend on rough diamond prices, currencies, and other costs. The South lobe carries the resource, but economic exploitation is dependent on rough prices given the costs of a pit push back or an underground option. In addition, with a plant, it is possible that other smaller deposits in the vicinity could ultimately be toll treated at Karowe or vended into Lucara.

Achieved rough prices are also critical to the project. Prices are determined by the range of diamonds recovered and also, we believe, by the way that they are sold. Lucara is not able to predict a continuation of the recovery of large white or blue diamonds; hence, we model based on guided prices excluding the benefits of specials, which could be significant. Another important consideration in the received price for smaller producers is the way and the location in which sales take place. The Botswana government took the right decision, we believe, in allowing Karowe goods to be shown in Antwerp after first viewings in Gaborone; this has increased attendance at the tenders and has, we believe, generated better-realised prices. Our conclusion is based on our visits to two of the tenders and talking to participants.

Mothae needs higher prices to become a mine

The Mothae project is a low-grade, higher value deposit in northeast Lesotho, northwest of Gem Diamonds' Letseng mine, and east of the Liqhobong project being developed by Firestone Diamonds. It is relatively remote and accessible on a gravel road, being at an elevation of nearly 3,000 metres above mean sea level. Infrastructure is relatively undeveloped; a power line runs not far from the project but is unlikely to provide sufficient power (approximately 10MW) to run a mine. In addition, as with most mines in the Lesotho Highlands, tailings pose some challenges as does the transport of water to site.

Exhibit 11: Lesotho's major kimberlites

Source: Company reports

The project is 75% owned by Lucara with the Government of Lesotho free-carried for half of the capex and development costs of its 25% stake. The project agreement allows Lucara to recover all of the government's 12.5% contributing interest from the government's share of dividends. The mining lease expires in 2019 with a 10-year renewal option. Until full production, royalties for the project were set at 4% of sales value of the diamonds; this rises to 8% on commercial production.

Exhibit 12: Mothae resources Q1/13

Class	Tonnes (MM)	Grade (cpht)	Carats (000)	Value ($/ct)
Indicated	2.39	3	71.7	1196
Inferred	36.57	2.7	987.4	1053

Source: Company reports

Lucara concluded a trial-mining programme in September 2012, processing some 604,000t to recover 52,017 diamonds weighing 23,445cts. The grade from trial mining (not 43-101) was 3.88cpht. As with many pipes in Lesotho, the prospect of a mine on Mothae, given potentially large capex, will be dependent on the incidence of fine large diamonds in the population. The mine is on temporary care and maintenance while the economics are considered.

The future for Mothae – joint development an option?

We ascribe a small ($50 million) valuation to Mothae in our model. This is because the project completed trial mining in September 2012 and work continues on a Preliminary Economic Assessment. Our view is that the project is unlikely to gain approval given potential project capex, infrastructure constraints (mainly electricity), and the fact that higher diamond prices will be needed to provide an economic model for a mine. A solution might be joint development with another mine in the area, and this was one of the potential synergies that was explored when Lucara and Gem disclosed preliminary merger talks in 2011, which did not progress.

Financial focus

Income statement – increasing production drives revenue

We assume that Lucara slightly exceeds its updated production guidance for 2013 of 420,000ct, with production and sales of 427,000ct. Our assumptions exclude the potential for an additional large and exceptional tender in H2 (the tender held in H1 raised $25 million). We currently model revenues of $116 million; prices are assumed to escalate at a rate of 5% in FY14, 4% in FY15 and 2% pa thereafter. We assume an operating cost of $23/t, driving opex of $57 million; costs are assumed to escalate at a rate of 2% per annum, and production is forecasted to remain steady at 2.5mtpa. We model a royalty of 10% of sales ($12 million) and DD&A of $18 million—this results in income from mining operations of $30 million. We assume that tax losses of $216 million (as of 31 December 2012) set off any cash taxes until 2017. Sales and marketing costs are forecasted at 3% of revenue, while we estimate care and maintenance costs at Mothae of $75,000/month and admin costs of $7 million/year.

Cash flow – bond repayments dominate in near term

We assume that Lucara is immediately cash flow positive, with operating cash flow rising to $82 million in 2016 from a forecasted $38 million in 2013 before reducing due to cash taxes. We assume that Lucara keeps to the repayment profile of its interest free bond and repays $8.3 million/quarter until full repayment in Q2/14. In addition, we assume that the balance of the $25 million revolving credit facility (RCF, $4.2 million) is repaid in Q2/13, thereby leaving the company debt free by June 2014 with available facilities of $25 million. We assume no expansion capex and sustaining capex of $5 million; remedial costs of $17 million are forecasted to be spent in 2026 or 2027. We assume that with $38 million of debt repayments in 2013, Lucara is slightly FCF negative in 2013 ($6 million); however, after this point, with rapidly decreasing debt obligations, the company is FCF positive. We do not forecast any dividend payments but note that should the company build sufficient cash reserves to support operating costs of nine months to a year, then any additional cash flow could be returned to shareholders.

Balance sheet – debt free from H2/14

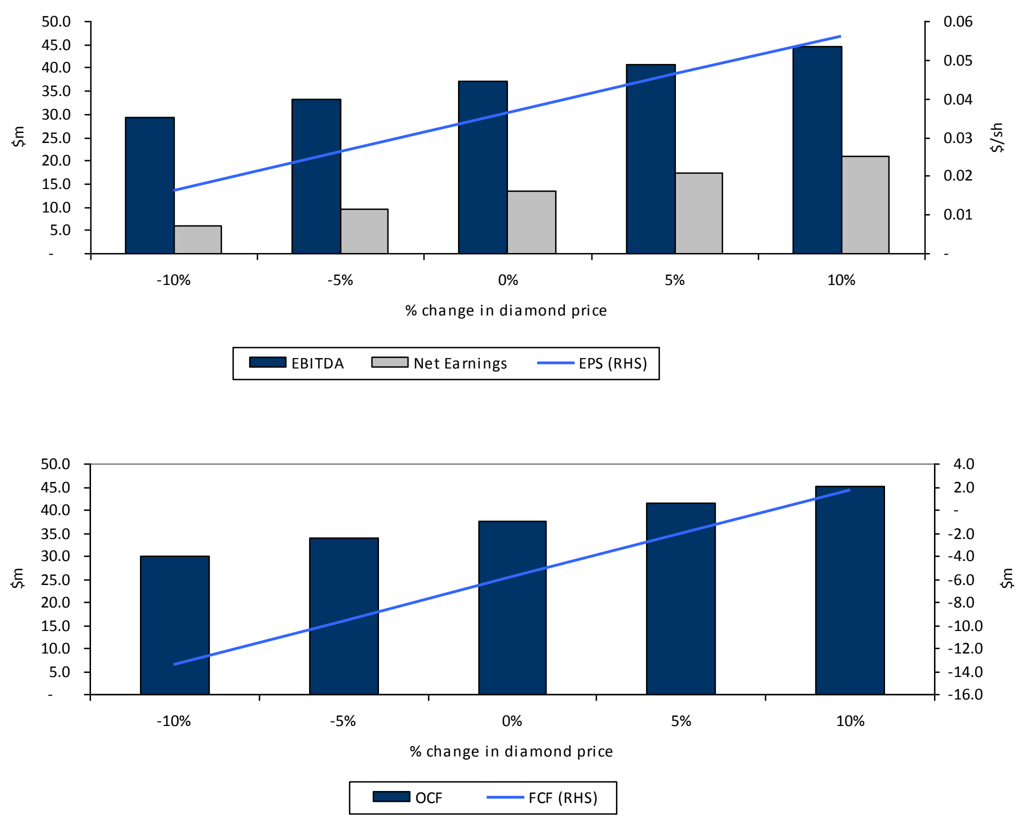
We assume that Lucara has a robust balance sheet, with a net debt position in 2013 reversing to net cash in 2014. The company is forecasted to have no debt on the balance sheet by mid-2014 (although a $25 million facility remains), and we expect it to have positive net current assets by Q1/14 as debt is paid down. Existing debt facilities include a $50 million zero interest corporate bond ($8.3 million has already been repaid) and a $25 million RCF. The bond has a repayment profile of $8.3 million/quarter and, as noted, is due to be repaid in H1/14. Non-current assets include mineral properties and PP&E, which are depreciated or amortised on an annual basis.

Sensitivities – flexing for diamond prices, opex and grade

In Exhibits 13 and 14, we flex our model to reflect the effect on earnings and cash flow when diamond prices and opex costs are adjusted. A 10% decrease in diamond prices would:

- Cut our 2013E EBITDA by 20%;
- Reduce earnings by 56%;
- Reduce operating cash flow by 20%; and
- Push free cash flow further into negative territory at $13.4 million.
- A 10% increase in prices increases our earnings by 56% and makes FCF into positive territory ($1.7 million).

Exhibit 13: Flexing 2013E earnings for diamond price sensitivities



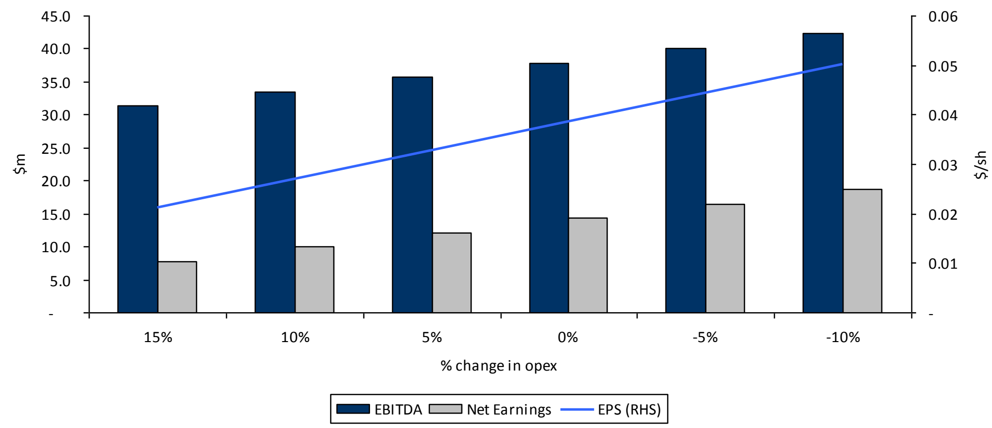
Source: RBC Capital Markets estimates

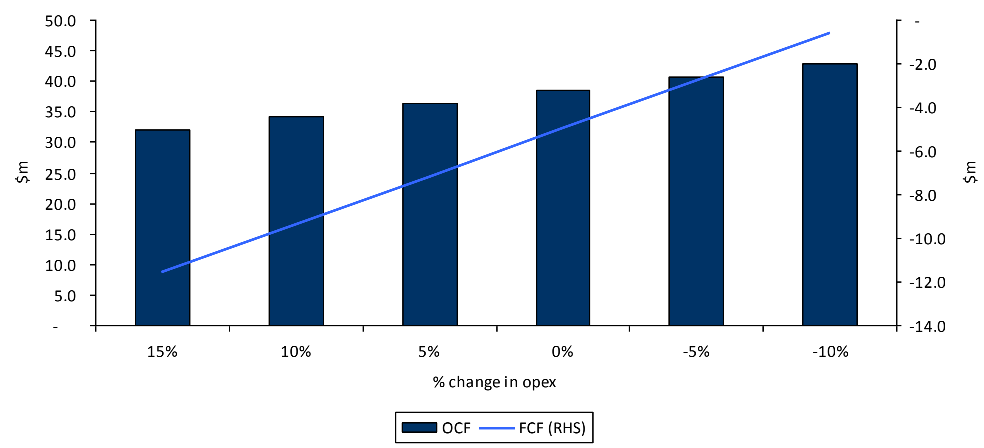
Exhibit 14 shows the effect of a movement in opex. Lucara is currently locked into a contract mining agreement, which we believe could yield cost savings upon expiry in 2015.

We estimate that a 15% increase in opex could:

- Depress 2013E EBITDA by 15%;
- Cut earnings by 42%;
- Reduce operating cash flow by 15%; and
- Further depress FCF to -$11.6 million.
- A 10% improvement in opex costs could improve EBITDA by 14% and earnings by 38%. In addition, FCF improves to -$0.6 million.

Exhibit 14: Flexing 2013E earnings for opex sensitivities





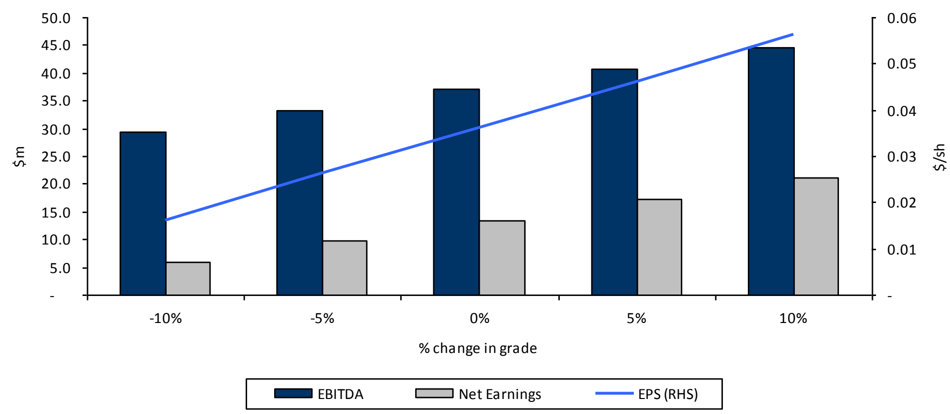
Source: RBC Capital Markets estimates

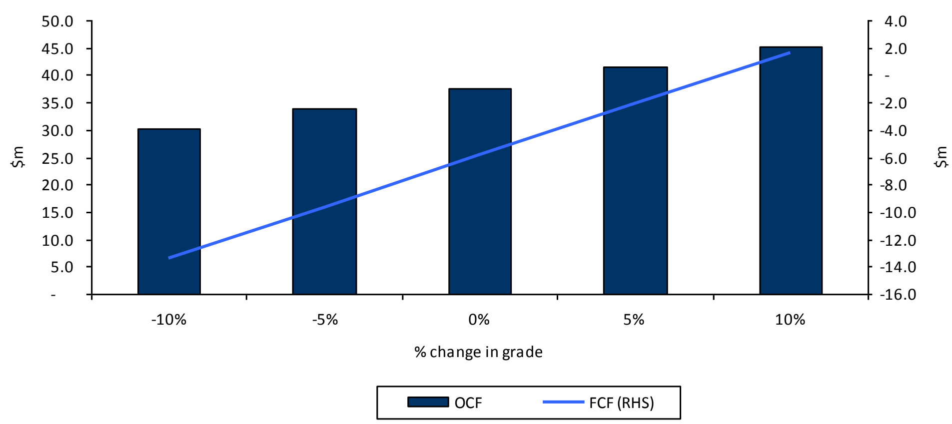
Des Kilalea +44 20 7653 4538; des.kilalea@rbccm.com

Exhibit 15 shows the effect of a change in forecast grade. We estimate that a 10% decrease in grade could:

- Cut revenue by 7%;
- Reduce EBITDA by 20%;
- Reduce earnings by 56%; and
- Depress FCF to -$13.4m from -$5.9m.
- A 10% improvement in grade would increase EBITDA by 20%, increase earnings by 56% and improve FCF to -$1.3m.

Exhibit 15: Flexing 2013E earnings for grade sensitivities





Source: RBC Capital Markets estimates

Shareholders

Lucara's shareholders are split with about one-third in Canada while the UK and Guernsey account for nearly 40%. The latter is in part a reflection of the African Diamonds transaction. Major shareholders include Chairman Lukas Lundin, both directly and indirectly, with almost 17.5% of the company. Directors and management own around 20% of the company's outstanding shares.

Board and management

The board of the company comprises several individuals with significant experience in the diamond sector including Canadian geologist Eira Thomas (North Arrow). Management (see below) includes former De Beers mining executives (CEO William Lamb and VP Development Tony George) as well as Larry Ott who has diamond experience across several countries, including with BHP Diamonds.

The board of Lucara comprises a chairperson and five directors, with only one (CEO William Lamb) being executive.

Lukas Lundin – Chairman: One of the company's founders and involved in several listed mining ventures globally.

William Lamb – Chief Executive Officer: A metallurgist with experience in the gold, platinum, chrome, and coal sectors, as well as having experience in the design and construction of diamond plants with De Beers in South Africa and Canada.

Paul Day – Chief Operating Officer: A mining engineer with experience in open-pit and underground mining in South Africa, Ghana, Mali, and Namibia, including with AngloGold Ashanti.

Tony George – VP Development: A mining engineer with experience in mine design and construction in diamonds, gold, base metals, and iron ore, including with De Beers in South Africa and Namibia.

Larry Ott – VP Exploration: A geologist with experience in mineral exploration and production in several countries, including significant time spent in exploration and resource development in diamonds.

Glenn Kondo – Chief Financial Officer: A chartered accountant with experience in the mining industry, including with Anglo American. Expertise includes M&A and business restructuring and project management.

Investment Summary & Valuation

We have visited the Karowe mine on several occasions during the exploration, bulk sample and development phases. This is one of the few projects which has been completed within budget in the diamond space, and ramped up on time. It is now running at a steady state. Over its life, the mine will move gradually into rock that carries less revenue, but cost containment should come as the company moves to owner operation next year. The recent large diamond tenders have also put Lucara in a sound position to repay its $50 million debenture during the next 18 months or so.

With Mothae unlikely to get a green light for development in the near future, it leaves Lucara open to other potential M&A opportunities in southern Africa. This could include ventures on neighbouring small kimberlites in Botswana or in buying into late exploration projects. As for Lesotho, there is still potential for consolidation, and Lucara appears relatively well positioned given that it will have a strong balance sheet once the debenture is repaid. Unless there is M&A, we see Lucara becoming a dividend paying company subject to rough prices keeping Mothae on care and maintenance.

Exhibit 16: RBC valuation and price target ($ millions, except per share data)

Net Asset Value @ 8%	2013E	2014E	2015E
Karowe (100%)	$382	$370	$346
Mothae (75%)	$50	$50	$50
Operating NAV	$432	$420	$396
Corporate Adjustments	($58)	($55)	($53)
Net Asset Value	$374	$365	$343
Shares Out (Basic)	375	376	376
NAV Per Share (US$)	**$1.00**	**$0.97**	**$0.91**
NAV Per Share (CAD)	**C$1.02**	**C$0.99**	**C$0.93**
Target price (CAD)	**C$1.05**		

Source: Company reports, RBC Capital Markets estimates

Now that Karowe is running, management is considering its options to expand the company (including Mothae if economics improve); this could see M&A or the building of an exploration portfolio. Given that Karowe is cash generating we belied M&A would be welcomed by the market provided it added value.

Our valuation of Lucara is based on a blend of 1x NAV and 10x a blend of 2014E and 2015E earnings. Our NAV is based on a DCF (8%) model of Karowe (the same metric as with other diamond companies we cover) generating a value of $382 million plus a $50 million valuation for Mothae. The key to our using a higher price:NAV multiple than for some of the other companies under coverage is that there is no project risk at present and that the company is moving into a position where it should be able to think about paying dividends. Our Price Target is C$1.05, and our recommendation is Outperform.

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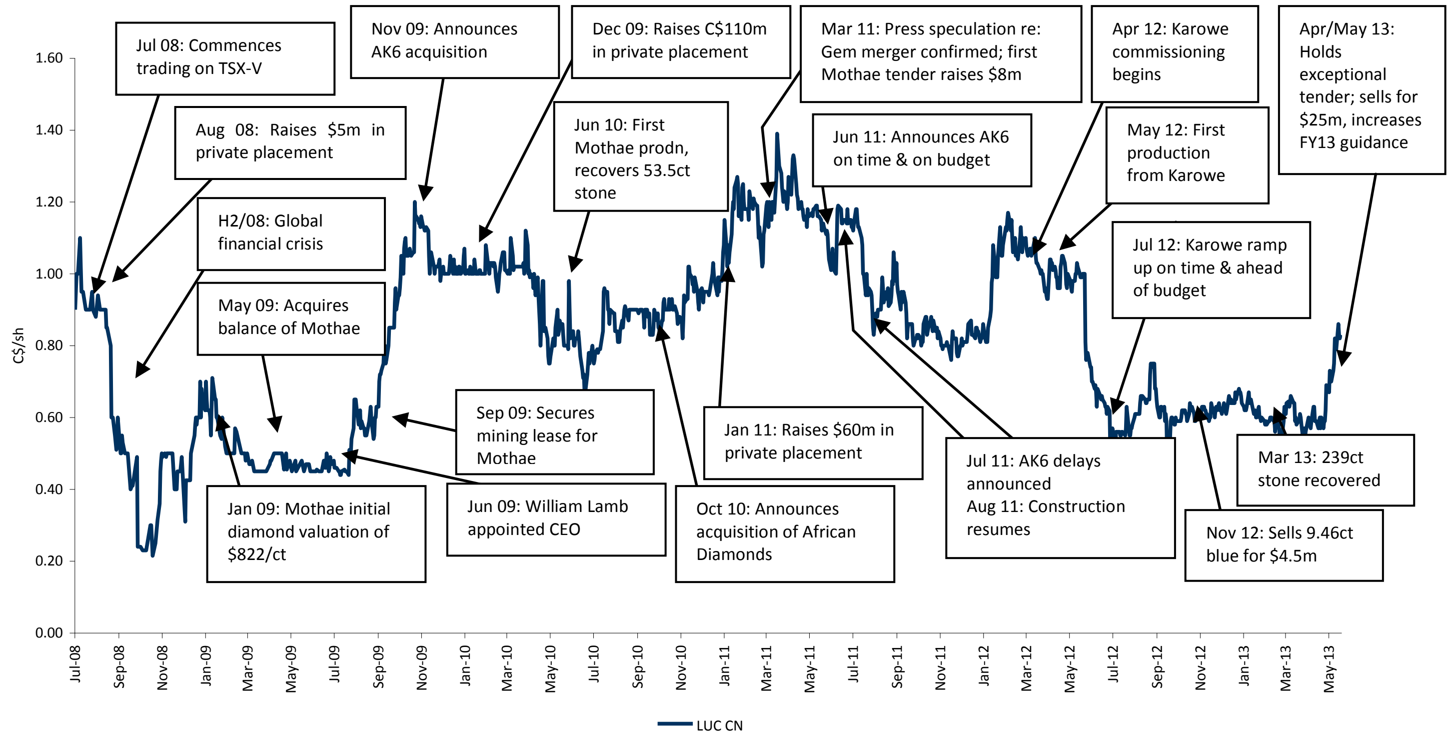
Exhibit 17: Lucara share price performance



Source: Bloomberg, RBC Capital Markets estimates

Price Target Impediments

Risks to achieving our price target include:

- World economic growth and diamond prices,
- Mine production levels,
- The inability to restart or dispose of Mothae,
- Increasing costs once the contract mining agreement at Karowe ends, and
- The 15% shareholding of Chairman Lukas Lundin.

Exhibit 18: Lucara Diamond Corp financial statements

Lucara Diamond Corp

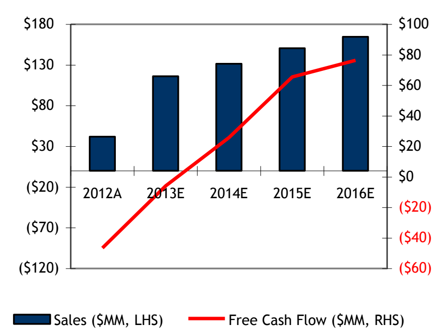
Outperform

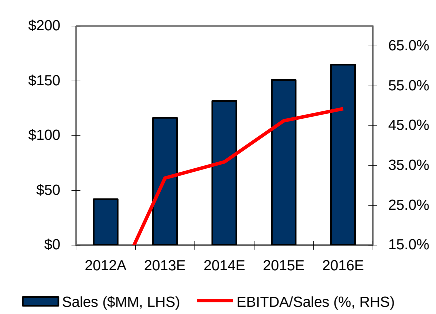
TSX:LUC, BSE: LUC, NASDAQ OMX First North: LUC

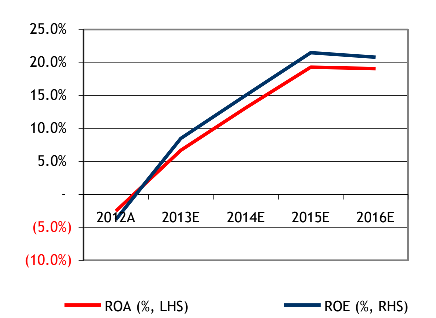
Figures in US$MM, unless otherwise noted

Valuation	2012A	2013E	2014E	2015E	2016E
Basic EPS, reported	($0.02)	$0.04	$0.08	$0.14	$0.17
Underlying EPS	($0.02)	$0.04	$0.08	$0.14	$0.17
EPS Growth	nm	nm	108%	82%	22%
P/E	nm	23.9x	11.5x	6.3x	5.2x
CFPS	$0.01	$0.10	$0.13	$0.19	$0.22
P/CFPS	103.9x	8.6x	6.9x	4.6x	4.0x
EV/EBITDA	-1653.4x	8.8x	6.0x	3.1x	1.7x
Dividend Per Share	$0.00	$0.00	$0.00	$0.00	$0.00
Dividend Yield (%)	-	-	-	-	-
Weighted Average Shares Out, Basic (MM)	374.6	376.3	376.3	376.3	376.3
Average Share Price	C$0.79	C$0.85	C$0.85	C$0.85	C$0.85
P&L	**2012A**	**2013E**	**2014E**	**2015E**	**2016E**
Total Revenue	$42	$116	$131	$151	$165
Operating Costs	($42)	($79)	($84)	($81)	($84)
EBITDA	($0)	$37	$47	$70	$81
D&A	($6)	($18)	($18)	($18)	($18)
EBIT	($6)	$19	$29	$52	$63
Net Interest Expense	($3)	($2)	($1)	($0)	($0)
Others	$2	($3)	$0	$0	$0
Provison for Taxes	$0	$0	$0	$0	$0
Minority Interests	$2	($0)	($0)	($0)	($0)
Preferred Dividends	$0	$0	$0	$0	$0
Net Earnings to Equity Shareholders	($6)	$13	$28	$51	$63
Cash Flow	**2012A**	**2013E**	**2014E**	**2015E**	**2016E**
Operating Profit	($8)	$14	$28	$52	$63
DD&A	$9	$18	$18	$18	$18
Income tax paid	$0	$0	$0	$0	$0
Working Capital & Other	$1	$6	$1	$1	$0
Operating Cash Flow	$3	$38	$48	$70	$81
Capital Expenditure	($44)	($6)	($5)	($5)	($5)
Repayment of Long-term Debt	($5)	($38)	($17)	$0	$0
Preferred Dividends	$0	$0	$0	$0	$0
Free Cash Flow	($47)	($6)	$26	$65	$76
Common Dividends	$0	$0	$0	$0	$0
Dividends Paid to Minority Interests	$0	$0	$0	$0	$0
Issuance/Buyback of Common Shares	$3	$0	$0	$0	$0
Other Financing Activities	($1)	($0)	($0)	($0)	($0)
Acquisition/Disposal of Assets	$0	$0	$0	$0	$0
Drawdown of debt	$10	$0	$0	$0	$0
Other Investing Activities	($0)	($0)	$0	$0	$0
Net Change in Cash	($35)	($6)	$26	$65	$76
Balance Sheet	**2012A**	**2013E**	**2014E**	**2015E**	**2016E**
Cash & Short-term Investments	$8	$7	$33	$98	$175
Total Current Assets	$27	$23	$49	$114	$191
Property, Plant & Equipment	$117	$104	$97	$90	$83
Other assets	$89	$74	$68	$62	$56
Total Assets	$233	$202	$215	$267	$330
Short-term Borrowing & Debt Due in One Year	$29	$16	$0	$0	$0
Total Current Liabilities	$47	$30	$14	$14	$14
Long-term Debt	$16	$0	$0	$0	$0
Other liabilities	$12	$12	$12	$12	$12
Total liabilities	$75	$41	$26	$26	$26
Minority Interests	$2	$2	$2	$2	$2
Common Shareholders' Equity	$155	$159	$187	$239	$303
Total Liabilities & Shareholders' Equity	$233	$202	$215	$267	$330
Net Debt (Total Debt Less Cash)	$37	$9	($33)	($98)	($175)

12-Month Target	C$1.05
Analyst	**Des Kilalea**
	(44) 20 7653 4538
	des.kilalea@rbccm.com
Current Share Price	C$0.85
Price/NAV	0.8x
52-Week High	C$1.02
52-Week Low	C$0.49
Market Capitalization (CAD million)	£320
Exchange Rate (USD/CAD)	0.983
Market Capitalization (US$ million)	$314
Basic Shares Outstanding (million)	376
Float (million)	302
Year-end	31-Dec
Reporting Currency	US$
Return to target (%)	24%







Lucara Diamond Corp

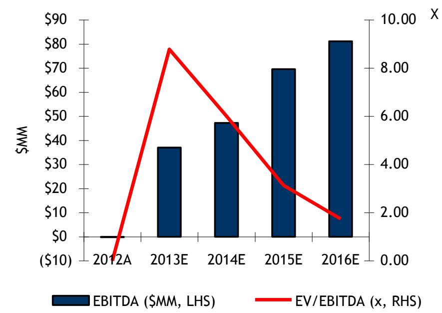
TSX:LUC, BSE: LUC, NASDAQ OMX First North: LUC

Outperform

Figures in US$MM, unless otherwise noted

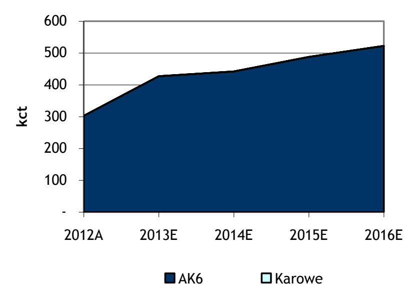
12-Month Target C$1.05

Half Yearly P&L	H1/12A	H2/12A	H1/13E	H2/13E
Total Revenue	$0	$42	$64	$52
EBITDA	$0	$24	$30	$17
Net Earnings to Equity Shareholders	($12)	$4	$12	$2
Basic EPS, reported	($0.03)	$0.01	$0.03	$0.00
CFPS	($0.05)	$0.06	$0.07	$0.03



Ratio Analysis	2012A	2013E	2014E	2015E	2016E
Sales Growth (%)	nm	178%	13%	15%	9%
EBITDA/Sales (%)	(0.5%)	31.8%	35.9%	46.2%	49.2%
EBIT/Sales (%)	(14.6%)	16.4%	22.2%	34.2%	38.3%
Net Earnings/Sales (%)	(14.1%)	11.6%	21.4%	34.2%	38.3%
Effective Tax Rate (incl Royalties)	(125%)	46%	32%	23%	21%
Net Interest Coverage (EBIT/Interest Charges)	-2.0x	7.9x	32.0x	118244.8x	144721.9x
Net Debt/Equity	23.8%	5.4%	(17.6%)	(41.1%)	(57.7%)
Net debt/ Total Capitalization	18.3%	4.9%	(17.4%)	(40.8%)	(57.4%)
EV/EBITDA (x)	0.0x	8.8x	6.0x	3.1x	1.7x
Return on Assets (ROA)	(2.5%)	6.7%	13.1%	19.3%	19.1%
Return on Equity (ROE)	(3.8%)	8.5%	15.0%	21.5%	20.8%
Return on Capital Employed (ROCE)	(3.0%)	7.7%	15.0%	21.5%	20.8%

Attributable production (000ct)



Key Commodity & FX Assumptions	2012A	2013E	2014E	2015E	2016E
Diamond Prices (US$/ct)					
AK6	$269	$276	$297	$309	$315
Karowe	$0	$0	$0	$0	$0
Currencies					
ZAR/US$	8.21	9.11	9.00	9.00	9.00

Key Commodity Production (000 cts)	2012A	2013E	2014E	2015E	2016E
AK6	303	427	443	488	523
Karowe	-	-	-	-	-
Total Production	303	427	443	488	523

Net Asset Value @ 8%	2013E	2014E	2015E
Karowe (100%)	$382	$370	$346
Mothae (75%)	$50	$50	$50
Operating NAV	$432	$420	$396
Corporate Adjustments	($58)	($55)	($53)
Net Asset Value	$374	$365	$343
Shares Out (Basic)	375	376	376
NAV Per Share (US$)	**$1.00**	**$0.97**	**$0.91**
NAV Per Share (CAD)	**C$1.02**	**C$0.99**	**C$0.93**
Target price (CAD)	**C$1.05**		

Priced as of market close June 14, 2013 ET
Source: Company reports, RBC Capital Markets estimates

Exhibit 19: Diamond Comps Table

Company	Tick	Price Curr	Report Curr	Analyst	Rating	Risk	Price	Target (12m)	Return to Target	52 Wk High	52 Wk Low	NAV/sh Est	P/NAV	Shares (MM)	Mkt Cap (US$M)
Petra Diamonds	PDL	GBP	USD	DK	O	nm	£1.19	£1.60	34%	£1.32	£0.97	£1.99	0.60x	500	$934
Gem Diamonds	GEMD	GBP	USD	DK	SP	nm	£1.17	£1.70	45%	£2.26	£1.15	£0.60	1.96x	138	$254
Stornoway Diamonds	SWY	CAD	CAD	DK	O	Spec	C$0.59	C$1.20	103%	C$0.96	C$0.46	C$0.88	0.67x	146	$85
Dominion Diamond Corp	DDC	USD	USD	DK	O	nm	$14.90	$22.00	48%	$16.85	$11.00	$24.04	0.62x	85	$1,262
Mountain Province Diamonds	MPV	CAD	CAD	DK	O	Spec	C$5.29	C$6.00	13%	C$5.62	C$3.43	C$6.10	0.87x	94	$490
Lucara Diamond Corp	LUC	CAD	USD	DK	O	nm	C$0.83	C$1.05	27%	C$0.86	C$0.50	C$1.02	0.82x	376	$222
Global									**49%**				**0.94x**		**$3,025**

Company	CFPS 2012A	CFPS 2013E	CFPS 2014E	CFPS 2015E	P/CFPS (2) 2013E	P/CFPS (2) 2014E	P/CFPS (2) 2015E	EPS 2012A	EPS 2013E	EPS 2014E	EPS 2015E	P/E (2) 2013E	P/E (2) 2014E	P/E (2) 2015E	Free CF Yi 2013E
Petra Diamonds	$0.17	$0.19	$0.41	$0.66	9.9x	4.6x	2.8x	$0.08	($0.00)	$0.14	$0.28	nm	13.2x	6.7x	(0.8%)
Gem Diamonds	($0.72)	$0.20	$0.26	$0.36	9.1x	7.0x	5.1x	($0.72)	$0.20	$0.26	$0.36	9.1x	7.0x	5.1x	(8.3%)
Stornoway Diamonds	(C$0.16)	(C$0.07)	(C$0.06)	(C$0.08)	nm	nm	nm	($0.18)	($0.08)	($0.07)	($0.08)	nm	nm	nm	(76.4%)
Dominion Diamond Corp	$1.30	$1.35	$1.67	$2.61	11.0x	8.9x	5.7x	$0.29	$0.41	$6.32	$1.08	36.3x	2.4x	13.9x	3.9%
Mountain Province Diamonds	(C$0.13)	(C$0.14)	(C$0.16)	C$0.27	nm	nm	19.0x	($0.01)	($0.14)	($0.16)	$0.27	nm	nm	19.0x	(23.9%)
Lucara Diamond Corp	C$0.01	C$0.10	C$0.13	C$0.19	5.9x	4.7x	3.2x	($0.02)	$0.04	$0.08	$0.14	16.3x	7.9x	4.3x	(2.6%)
Global					**10.0x**	**6.8x**	**8.2x**					**22.7x**	**7.5x**	**11.2x**	**(21.1%)**

Company	Production 2011A	Production 2012A	Production 2013E	Production 2014E	Production 2015E	Production 3YΔ	Cash Costs 2011A	Cash Costs 2012A	Cash Costs 2013E	Cash Costs 2014E	Cash Costs 2015E	Cash Costs 3YΔ	Reserve (P&P)	Resource (M&I)	AMC/ Rsrv
	000 carats						US$/ct						MM cts	MM cts	(US$/ct)
Petra Diamonds	1,118	2,209	2,663	3,142	3,725	19.0%	$116	$103	$103	$82	$82	(7.1%)	7	80	$133.38
Gem Diamonds	213	236	74	82	83	(29.3%)	$1,380	$831	$1,334	$1,460	$1,553	23.2%	1	18	$182.18
Stornoway Diamonds	-	-	-	-	-	-	$0	$0	$0	$0	$0	-	0	24	n.m.
Dominion Diamond Corp	2,600	2,815	4,185	4,464	5,252	23.1%	$52	$54	$68	$81	$81	14.9%	54	138	$16.70
Mountain Province Diamonds	-	-	-	-	830	-	n.m.	n.m.	n.m.	n.m.	$68	-	0	61	n.m.
Lucara Diamond Corp	n.m.	303	427	443	488	17.2%	n.m.	$28	$28	$29	$28	(0.5%)	0	16	n.m.
Global							**$387**	**$247**	**$376**	**$406**	**$357**				**$110.75**

Footnotes:

TP - Top Pick; O - Outperform; SP - Sector Perform; U - Underperform. Spec - Speculative Risk

DK - Des Kilalea

(1) AMC (Adjusted Market Cap) calculated as market cap plus long-term debt less working capital

(2) P/CFPS and P/E multiples higher than 80x excluded from analysis

(3) Free Cash Flow is calculated as: Operating Cash Flow - Debt Repayments - Capex

Dominion Diamond Corp figures are for the year ended January 31. Petra Diamonds figures are for the year ended June 30.

Source: Company reports and RBC Capital Markets estimates

Des Kilalea +44 20 7653 4538; des.kilalea@rbccm.com

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