

# Lucapa Diamond Co. Ltd

## (LOM \$0.34) Speculative Buy

EUROZ

Analyst	Date	Price Target
Greg Chessell	7 <sup>th</sup> June 2017	\$0.60/sh

### Company Update

#### Investment case

Lucapa is a profitable producer and self-funding explorer of high value diamonds. The Lulo (Angola) alluvial diamond mining operations, producing the highest average diamond value of any mine in the world, is on course to achieve a similar gross sales outcome as in 2016. Exploration for the kimberlite source is exciting, and gaining momentum with discovery of Kimberlite 2km upstream from the most prolific alluvial block. If proven diamondiferous we expect a material rerating. The large size and irregular shape of alluvial diamonds recovered from MB08 suggest the source is proximal. The Mothae acquisition is an exciting medium term high value kimberlite diamond development opportunity that will grow value in time. The high value diamond segment is robust due to scarcity of supply and growth of uber-wealthy individuals globally. Our valuation has been upgraded to \$0.60/sh.

#### Update

Lucapa is exploring for the kimberlite source of the diamonds that it is currently mining from the Lulo concession in Angola. The alluvial diamonds have the highest average value per carat of any diamond mine globally. To date Lulo has produced 31kct averaging US\$2,300/ct.

The largest stone recovered at Lulo is 404ct, making it the largest ever recovered in Angola, and the 27th largest ever reported in history. This stone sold for US\$16m in 2016.

Lucapa owns 40% in SML, the incorporated alluvial mining subsidiary, and has a 39% stake in the overlapping unincorporated kimberlite exploration concession.

The onset of the dry season has enabled drilling activity to ramp-up, and to access areas not possible during the wet season. The dry season will also enable alluvial production from the higher grade blocks. Consequently we expect improved production and cashflow from SML over the coming 6 months or so.

#### Exploration

Kimberlite rock has been intersected at prospect L14 in the 1st drill hole (HJ/014/01) from 10m to at least 57m. This development is significant because it:

- Is coarse kimberlite;
- Contains visually observed indicator minerals;
- Occurs near surface;
- Proximal to (2km) and upstream from prolific alluvial block MB08.

Lucapa has previously referred to experienced consultant diamond geologist Dr John Ward who stated that based on the diamonds recovered from Mining Block 08, it is "..... highly likely to be within 1.5km of the primary source" (ref our LOM initiation note, 22nd Dec 2016).

Laboratory analysis of the core will be conducted in Sth Africa to profile the indicator mineral species, and examine for micro-diamonds. Exporting of the drill core requires regulatory approval, adding a unique time dimension. Consequently we expect results during July.

Drilling of additional holes at L14 is ongoing, subject to access, in order to define the shape of the pipe. Drilling is using the new track-mounted high capacity drill rig (Hanjin).

Lucapa Diamond Co	Year End 31 Dec	
Share Price	0.340	\$/sh
Issued Capital		
Fully Paid Ord	330	m
Options (m)	\$0.20	46 m
Options (m)	\$0.35	12 m
Options (m)	\$0.53	3 m
Options (m)	\$0.45	3 m
Perf Rights	5	m
<b>Total Diluted</b>	<b>394</b>	<b>m</b>
Mkt Cap (dil)	134	\$m
Enterprise Value	123	\$m
Debt	-6	\$m
Cash	3	\$m
Turnover	1.5m sh/day	
12 mth Lo-Hi	\$0.29 - \$0.55	
Balance Date	31st Dec	

#### Directors

M Kennedy	Chair
S Wetherall	CEO
G Gilchrist	NE Dir
A Thamm	NE Dir
N Selby	COO

#### Shareholders

Carrington	6.1%
Dir & Mgt	1.5%

#### Company Details

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#### Share Price Chart



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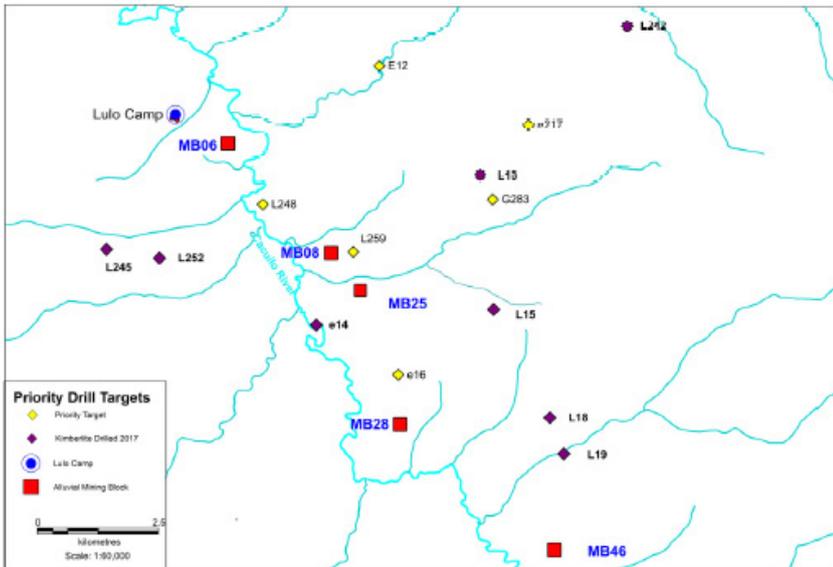
The L14 prospect was highlighted and refined through the recent airborne TDEM geophysics survey.

Coarse near surface kimberlite has also been intersected in drilling at prospects L13, L15 & L242. However location of these are more distal to the alluvial mining areas, and no mention of indicator minerals has been made.

Further drilling is planned for all prospects mentioned, and also new prospects e12 & G283.



Source: Lucapa Diamond Co. Ltd



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#### Mothae, Lesotho

Lucapa secured funding to complete acquisition of a 70% stake in Mothae for US\$9m, and to proceed with development of Stage 1 (US\$12m). It comprises:

- Underwriting of 46.2m Options due 30th Sep'17, exercisable at \$0.20/sh. This will yield A\$9.2m gross, or \$8.6m net;
- Bridging loan of A\$5.5m, secured, 6 month term, from First Class Securities P/L;
- Issue of 11.6m options exercisable at \$0.35/sh around 30th Sep'18, which are expected to yield A\$4.1m

Lucapa had US\$2m cash at 31st March, expected an additional US\$5.6m in distributions from SML, and has received A\$1m in option conversion during the June Q.

Lucapa has provided production and financial forecasts for its planned development of Mothae, Lesotho. We have adjusted our financial model to reflect this information.

The Mothae development highlights are:

- Capex - US\$90m, staged US\$12m in Yr1; US\$78m in Yrs3&4;
- Production - 15kctpa in Stage 1; 42kctpa in Stage 2;
- Sale price expected - US\$1,332/ct in Stage 1; US\$1,499/ct in Stage 2;
- Operating Cashflow (pretax) - US\$8.5mpa in Stage 1; US\$31mpa in Stage 2;
- Mine life - 12 years;
- Project NPV - US\$65m (10%, after tax); IRR 36% (after tax).

Lucapa must fund the development entirely, and recover its investment from project cashflows. Consequently free cash will be generated from 2012. We value Lucapa's share of Mothae at US\$50m.

Like Lulo, Mothae hosts high value diamonds, making it complementary to Lucapa's asset profile.

The high value end of the diamond market has been more robust in recent years as it has not been affected by the Indian demonetisation which has affected the smaller lower value diamond market, as noted by several larger diamond producers.

The average value per carat globally is -US\$100/ct, significantly below the value expected at Mothae. Lucapa forecasts a higher value per carat produced (avg US\$1,481/ct) than declared in the Mineral Resource Estimate (US\$1,063/ct) as it intends to discard the smaller lower value fraction (3mm v's 2mm screen).

Mothae is low grade, in terms of carats per tonne of rock, however this is mitigated by the high value per carat. The net result is a value per tonne range of US\$30-40/t, consistent with other Lesotho diamond mines (eg Liqhobong, Firestone - US\$37/t, and Letseng, Gem Diamonds - US\$29/t). Lesotho is renowned for its cluster of highest value per carat diamondiferous kimberlites globally, with Letseng being the highest at US\$1,695/ct in 2016.

Lucapa has noted it is considering a greater throughput in Stage 1, a plant capable of 150tph, compared with the 100tph considered in the financial forecasts.

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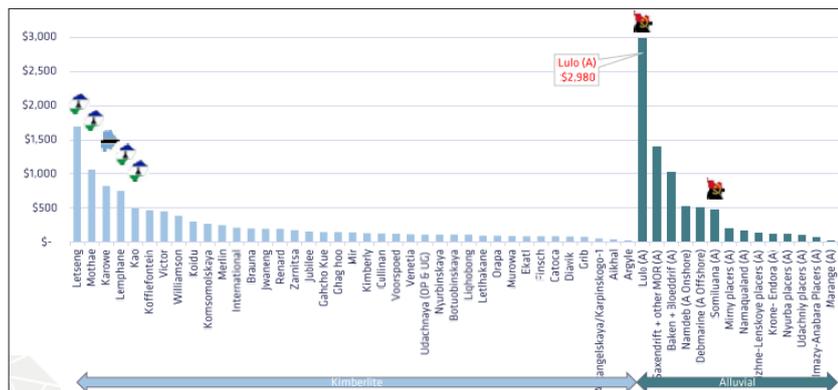
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Source: Lucapa Diamond Co. Ltd



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Valuation	US\$m	A\$m	A\$/sh
SML (LOM sh)	71	95	0.24
Kimberlite (LOM sh)	39	52	0.13
Mothae (LOM sh)	50	67	0.17
Other Expl'n		3	0.01
LOM Cash	2	3	0.01
LOM Debt		-6	-0.01
LOM WC	7	9	0.02
Unpaid Capital		13	0.03
<b>Total</b>		<b>236</b>	<b>0.60</b>

Mineral Resources						
Project	JORC	Vol/Tonnes '000	Grade cphm <sup>3</sup>	Grade cpht	Carats kct	Mod Value US\$/ct
Lulo (LOM 40%)	Inf	607	8.0		48	1,246
Mothae (LOM 70%)	Ind	2,390		3.0	72	1,196
	Inf	36,570		2.7	970	1,053
<b>Total</b>		<b>38,960</b>		<b>2.7</b>	<b>1,042</b>	<b>1,063</b>

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