

Quick Comment

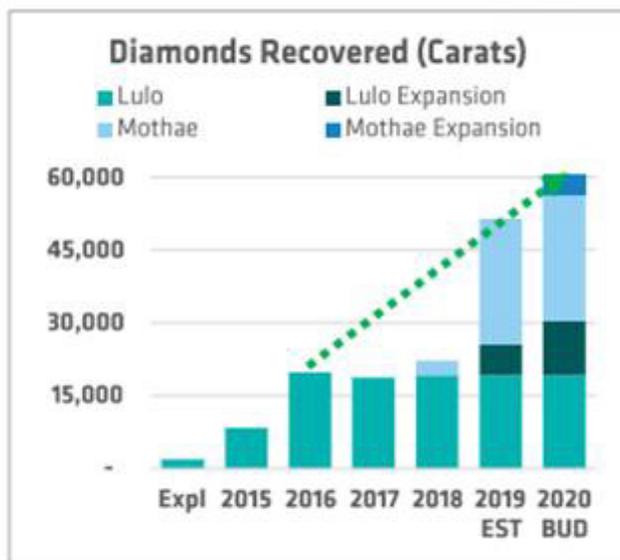
Lucapa Diamond Co Ltd (LOM \$0.16) Speculative Buy

Analyst	Date	Price Target
Michael Emery	6 th September 2019	\$0.61/sh

Company Transformation Starting to Bear Fruit

Key Points

- LOM has delivered a June H'19 result ahead of our expectations and meaningfully improved over PCP:
 - NPAT of US\$1.1m vs EZL US\$0m and beating PCP of US\$4.3m loss;
 - Associate SML (LOM 40%) NPAT US\$3.9m vs EZL US\$3.5m, PCP US\$3.0m loss;
- In absolute terms, the result may seem marginal however this marks another milestone in the exciting transformation of the Company towards a multi-asset expanding producer of rare high-value diamonds;
- Importantly, LOM delivered on key development and operational goals at Mothae and Lulo during the Half, providing a solid platform to spring into a thrilling H2 CY'19;
- We expect a meaningfully stronger H2 CY'19 operational and financial result that will demonstrate the potential run rate of the optimised and expanded production at Mothae and Lulo;
- The transformational growth of LOM can be seen below, with CY'20 expected to represent a 200% uplift in carats recovered from the Company's 2016 result:



- At Lulo, mining of the myriad untested new Mining Blocks has commenced producing spectacular early results with grades of >10cphm³, more than double our average forecast;
 - Importantly, the +4.8ct and Specials recovered in July and August already outnumber the entire H1 CY'19 result;
- Furthermore, the internally SML-funded expansion continues on schedule, aiming to increase prod. 50% to 450kbcm/year. The expansion will increase CFs to SML and accelerate loan repayments due to LOM;
 - Early evidence of successful expansion can be seen in record production for the month of August '19, recovering 3.2kcts vs EZL 2.5kcts;

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- At Mothae, mining has commenced in the higher-margin southern pit as dewatering continues, with operations expected to continue in this zone throughout CY19;
- We expect that mining in this zone will meaningfully increase the occurrence of high-value special diamonds, as evidenced by the recent discovery of a 64ct D-colour Type IIa, considered the best individual diamond recovered to date from Mothae;
- Further encouraging results are seen in record production during August '19, recovering 2.9kcts, a significant beat vs EZL 1.8kcts;
- From a price received standpoint, the H1 CY'19 result at Lulo and Mothae were slightly lower than long-term average, however the reduction was driven by LOM's decision to strategically withhold from sale two high-value diamonds to pursue its downstream cutting and polishing strategy;
- At Lulo, a high-value 46ct pink was withheld and at Mothae, a 36ct D-colour diamond is being considered for cutting and polishing;
 - We expect sale of these in H2 CY'19 will demonstrate the step-change in margins that LOM can receive from this strategy moving forward and will vindicate the decision to delay gratification on these rare high-value stones;
- We also point to the 7,001cts being held in inventory which we value at ~A\$8m based on recent sales, which points to the robust nature of LOM's transformed Balance Sheet;
- We continue to believe the market does not appreciate the bifurcated nature of diamond pricing, with prices of high-value diamonds such as those produced by LOM remaining robust, while low-value diamonds produced by the Company's peers experiencing significant pricing weakness;
- Expanding production of rare high-value diamonds aside, LOM continues the search for the source of the prolific alluvial diamonds found at Lulo, with the next phase of exploration launched during H1 CY'19. A discovery here will significantly re-rate the stock;
- Our Speculative Buy and PT of \$0.61/sh is maintained;

Investment Thesis

The transformation of LOM into a multi-asset producer of rare high-value diamonds is starting to bear fruit, evidenced by a Group H1 CY'19 profit. This marks another important milestone in the well-executed growth strategy of the Company and sets up a thrilling H2 CY'19 from both an operational and a financial standpoint. Self-funded expanding production at Lulo and recently commenced mining of the higher-margin zone at Mothae are sure to deliver record results moving forward, evidenced by August monthly performance 33% above our forecasts. We look to growing production, the exciting next phase of Lulo exploration and increased margins from downstream cutting and polishing as catalysts to re-rate LOM back towards our \$0.61/sh Price Target. Speculative Buy maintained.

Lucapa Diamond Co Ltd (LOM)

Share Price	0.16	A\$/sh	Enterprise Value	94	A\$m
Price Target	0.61	A\$/sh	Debt	21	A\$m
Valuation	0.61	A\$/sh	Cash	7	A\$m
Shares on issue	504	m(dil)	Largest ShareholderTazga Two	8.7%	
Market Capitalisation	81	A\$m			

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Contact Details

Euroz Securities Limited +61 8 9488 1400

Research Analysts

Jon Bishop - Head of Research	+61 8 9488 1481
Andrew Clayton - Resources Analyst	+61 8 9488 1427
Michael Emery - Resources Analyst	+61 8 9488 1430
Ben Laird - Industrials Director	+61 8 9488 1429
Gavin Allen - Industrials Analyst	+61 8 9488 1413
Seth Lizee - Associate Research Analyst	+61 8 9488 1414

Institutional Sales

Andrew McKenzie - Executive Chairman	+61 8 9488 1407
Rob Black - Managing Director	+61 8 9488 1423
Jay Hughes - Executive Director	+61 8 9488 1406
Russell Kane - Executive Director	+61 8 9488 1426
Simon Yeo - Executive Director	+61 8 9488 1404
Timothy Bunney - Executive Director	+61 8 9488 1461
Peter Schwarzbach - Executive Director	+61 8 9488 1492
Stacy Kitsantas - Institutional Adviser	+61 8 9488 1486

Private Client Advisers

Chris Webster - Head of Private Clients	+61 8 9488 1412
Ben Statham - Executive Director	+61 8 9488 1417
Brian Bates - Executive Director	+61 8 9346 0314
Cameron Murray - Executive Director	+61 8 9488 1440
James Mackie - Executive Director	+61 8 9488 1416
Lucas Robinson - Executive Director	+61 8 9488 1424
Ryan Stewart - Executive Director	+61 8 9488 1441
Tim Lyons - Executive Director	+61 8 9346 0324
Brett Stapleton - Associate Director	+61 8 9488 1435
Giles McCaw - Associate Director	+61 8 9488 1462
Michael Bowden - Associate Director	+61 8 9346 0307
Richard Gardner - Associate Director	+61 8 9488 1444
Paul Berson - Associate Director	+61 8 9346 0314
Paul Cooper - Associate Director	+61 8 9346 0316
Ian Harrison - Investment Adviser	+61 8 9488 1422
Lauren Walker - Investment Adviser	+61 8 9488 1495
Michael Bartley - Investment Adviser	+61 8 9346 0352
Tom Kenny - Investment Adviser	+61 8 9488 1431
Zac Vinten - Associate Adviser	+61 8 9488 1473

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