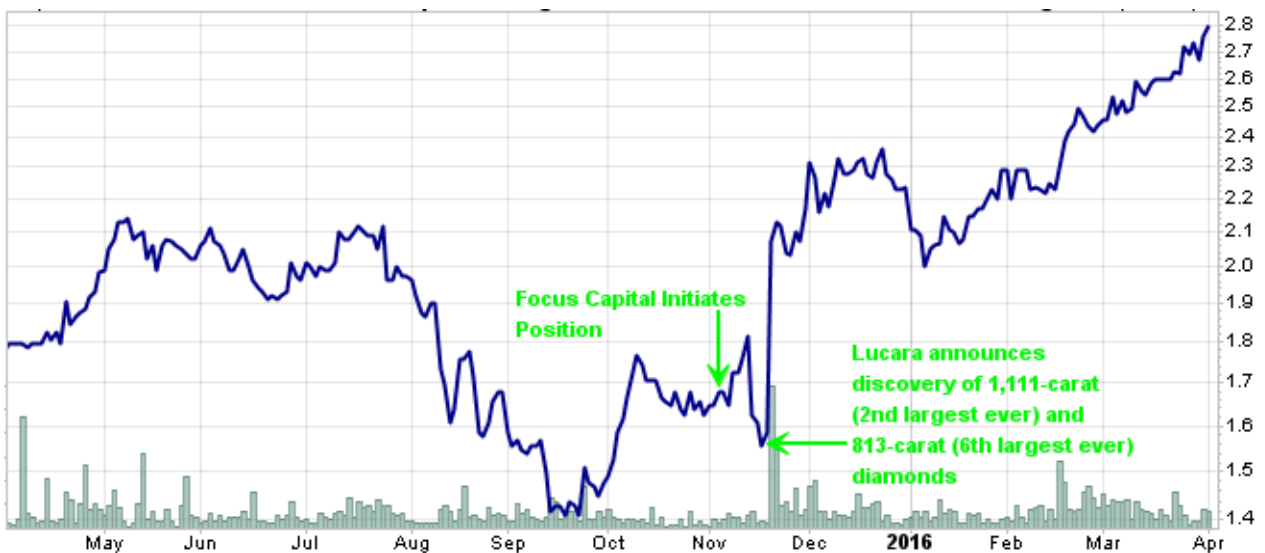


Lucara Diamond Corp. (Toronto: LUC) owns and operates the Karowe diamond mine in Botswana (one of the most stable mining countries in the world). The Karowe mine is unique in the profile of diamonds it produces. Although a small mine, it has been consistently and highly profitable, with a low cost per ton and high quality diamonds, netting top margins. Their unique feature is that about half of their revenue comes from tenders of high-end stones, rough diamonds that they value at \$1 million+ (e.g. a 342-carat colorless flawless stone). Lucara gets an average of \$30,000-\$40,000 per carat for these stones. These large, exceptional stones are found on a reliable and regular basis. In fact, although Karowe is the one of the smallest mines in the world (<1% of the global supply of carats annually), it nevertheless produces more than 50% of the world's annual supply of rough diamonds 100 carats and larger. Since the mine is quite profitable from just its regular diamonds, with their high quality and low cost of mining, the exceptional stones add a hugely significant, lumpy additional revenue, with little increase in operating expenses.

Lucara's unique mine profile and lumpy operating revenue have led to a severe market mispricing. The Fund initiated a position on November 4, 2015 at the price of \$1.69 CAD. At the time, Lucara had a market cap of ~\$490 million USD, reported net cash and other liquid assets of ~\$100 million USD (with no debt) and annual free cash flow of ~\$75+ million USD. Deducting the cash from the market cap yields an EV/FCF of ~5.2. To be totally blunt: Lucara Diamond was ridiculously undervalued.



With Lucara's unique mine profile and consistent discoveries of diamonds of 100-300+ carats, it was only a matter of time until they found the Big One. On November 18, 2015, Lucara announced that they found a 1,111-carat diamond, the largest rough diamond in more than a century, and the second-largest gem-quality diamond ever found in world history. Just a few hours later, Lucara announced that they found an 813-carat diamond, the sixth-largest ever. LUC immediately jumped to close the next day at 2.10, an increase of approximately \$141 million USD



Lucara Diamond Corp.

from the day before, 30% of its market cap. Although a major move in the stock price, this did not come close to a proper revaluation of LUC. To illustrate this, these two stones alone can be expected to sell for at least \$75-\$135 million USD (combined), netting Lucara (after royalties and taxes to Botswana) ~\$40-\$73 million USD. Considering the strong and clear endorsement of the value of Lucara's diamond deposits, the rise of just \$68-\$101 million USD beyond the value of the stones themselves was actually quite muted. In our opinion, Lucara remains deeply undervalued.

No discussion of an investment can ignore risks facing the company. The largest risk facing Lucara is their exposure to global diamond commodity prices, such as the ~20% drop in rough diamond pricing experienced in the second half of 2015. In our opinion, this risk is reasonably muted as it concerns Lucara as a long-term investment. On a long term forecast, diamond prices seem reasonably favorable, with supply dwindling and demand (particularly in China and India) continuing to increase. Perhaps more importantly, even in downturns (such as the aforementioned pricing pressure during 2015), the higher quality diamonds that Lucara produces suffer less. And the exceptional diamonds are almost a different asset class entirely and do not correlate much with commodity diamond prices.

The next major Lucara-specific catalyst that we expect (besides the selling of the 1,111 and the accompanying publicity) is an increase in indicated reserves and the feasibility report on underground mining, expected in late 2016 and 2017. We anticipate that the current open pit mine life of 2026 will be extended significantly by 12+ years. Lucara also has some other exploration properties in Botswana, which we view as free options.

We anticipate that over time, as Lucara continues to throw off cash and consistently produce world-class exceptional diamonds, the market will come to appreciate the unique asset that Karowe represents. We internally value Lucara to be worth at least \$1.5 billion USD, with possible upside as future events warrant. If they are able to purchase producing assets at reasonable prices or if one of their exploration properties proves worthwhile, their value can go up significantly. It is also quite possible, even likely, that with their tweaks to the production process to enable recovering larger and larger diamonds that they will continue to find whoppers in the 1000-carat range or larger. Even without these potential upsides, Lucara as it stands right now is greatly undervalued and is likely to provide significant returns for the patient long-term investor.

