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FAR EAST CAPITAL

The Mining Investment Experts

Diamond Company Review

21 August 2020

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# Lucapa Diamond Company Ltd

***"Selling at a substantial discount to projected earnings and cash flow streams"***

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| Share Price | 7¢ | |
| 12 Mth High/Low | 4.2¢-16¢ | |
| Market Cap'n | $44.9m | undiluted for opts. |
| Issued Shares | 641 | mill. ordinary |
| Options | 113 | mill. 10¢ strike |
| Total Shares/Opts | 754 | mill. shares + options |
| Cash Balance | US$4.5m | as at 30/6/20 |
| Largest Shareholders | | |
| Directors & Mgt | 10% | |
| Equigold | 8.1% | (also a financier) |
| New Azilian | 7.9% | (also a financier) |
| Debt owed by LOM | A$26m | |
| Loan owed to LOM | A$83m (Lulo and Mothae) | |

**Company Description**

Lucapa (LOM) is an ASX-listed diamond producer with two operating mines. The 40%-owned Lulo Alluvial Diamond Mine in Angola (SML) has been operating for over five years, having undergone successive successful expansions. It is notable for the very high value and size diamonds that are recovered. The 70%-owned Mothae Kimberlite in Lesotho is in its second year of production and it may soon be expanded from 1.1 Mtpa to 1.8 Mtpa treatment capacity. Exploration programs are underway to find the source kimberlite for the Lulo diamonds in Angola, as well as in Botswana and in the Ellendale region of WA.

**Positive Points to Look Forward to**

- Restructuring of debt position that delays repayments and reduces finance costs
- Proposed 60% expansion of Mothae mine capacity with estimated payback of less than one year
- Possible upgrading of status of Mothae resource categories, enabling more complete guidance and longer stated mine life
- Value-adding diamond sales strategies
- Continuing exploration program and news from kimberlite exploration program at Lulo
- Possible increase in equity in Lulo kimberlite exploration licence
- Repeated recovery of high value diamonds of more than 100 carats in size

***Investment Perspective****: Lucapa is an exceptional diamond company that has developed two high-end diamond mines over the past five years, making it the most successful ASX-listed diamond specialist since the 1990s. It owes its success to date on the following parameters;*

1. ***Quality of Diamonds:*** *It owns two of the three best quality diamond mines in the world, based on average value per carat.*
2. ***Diversity of Earnings****: It is the only producing diamond company in the small to midcap size with two operating mines, in two separate jurisdictions; Angola and Lesotho.*
3. ***Depth of Technical Skills and Diamond Knowledge:*** *Lucapa developed both of its mines as opposed to purchasing existing operations. Management has a proven record in developing and commissioning diamond mines as well as diamond market and specialist cutting and polishing knowledge, having learnt their skills whilst working for De Beers, Gem Diamonds and others earlier in their careers.*
4. ***Marketing Strategy:*** *Lucapa's operations have entered into value-adding marketing arrangements with leading diamond buyers that involve cutting and polishing activities, leading to higher revenue than what would come from standard industry rough auctions.*
5. ***Optimisation Strategies:*** *The company is reviewing all aspects of operations to improve its financial and operational performance.*
   i. *Lulo expansion - capacity has recently undergone a ~50% expansion with finance from internal cash flow*
   ii. *Mothae expansion - studies show that for a small investment Mothae can lift capacity by ~60%*
   iii. *Corporate overheads reduced substantially*
   iv. *Debt renegotiations have achieved moratoriums and deferment of repayments over the next two to three years*
6. ***Net Debt*** *While Lucapa owes A$26m in three facilities, it is in turn owed A$83m by the operating mines it has developed. Thus there is 3x coverage in Lucapa's favour.*

*Lucapa continues to offer blue sky speculative appeal through its kimberlite exploration program at Lulo in Angola. There is every reason to believe that the source pipe(s) for the alluvial mining operation will be found on the existing licence. This offers the potential for an asset worth billions of dollars as it may be one of the richest, high quality pipes around (based on the large quality stones recovered in the alluvial mining operations).*

## The Impact of Covid-19 on Operations

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| *Lockdowns initially and an aggressive cost reduction program* | Lucapa's initial response to Covid-19 was a lockdown of the operations in Angola and Lesotho. The Company instituted a heavy cost reduction program at head office in Perth. Corporate staffing levels were reduced and executive directors, other staff and contractors took a voluntary 60% cut to emoluments and fees until the end of the Quarter. |
| *Lulo now back on stream and heading to 100% of capacity* | After a number of weeks the Lulo operation recommenced production with 50% of personnel on site in May. The June Quarterly report stated that operations were heading back to 100% capacity and solid results have been reported since. |
| *Mothae still on care an maintenance* | At this point it seems that Mothae may remain on care and maintenance until the end of 2020. Lucapa can take advantage of this lull to assess and perhaps implement the scoped plant expansion from 1.1 Mtpa to 1.8 Mtpa at a time when there will be no interruption to production. |
| *Diamonds sales still happening for Lucapa* | There has been uncertainty about the ability to sell diamonds by usual tender showings, and there have been interruptions to demand. However, Lucapa managed to realise US$4m worth of sales in the June quarter, that were sold into the cutting and polishing partnership with SML's preferred buyer, Safdico International. Under this partnership agreement SML is paid the full rough market value of the diamonds upfront and it shares in a significant portion of polished margins generated thereafter. |
| *Resource definition of alluvials is continuing* | Auger drilling programs to delineate additional diamond bearing gravels have continued at a lesser rate, in both terraces and flood plain (leziria) areas along the Cacuilo River. An extensive new gravel deposit within Mining Block 06 was identified in the leziria area, which returned a high average grade of 17.5 cphm$^3$, twice the resource statement average. |
| *$5.2m entitlement issue boosted cash position* | A 1 for 5 entitlement issues closed fully subscribed, boosting cash levels to A$6.5m at quarter end. Additionally, SML (the Angola operating company) held cash and receivables of US$3.5m and 2,647 carats of diamond inventory. |
| *Another diamond sale nets A$5.1m in July* | Late in July, Lucapa announced another diamond sales that netted US$3.7m for SML (of which Lucapa owns 40%). The average price was US$1,400/ct, close to the average price of US$1,528/ct for the year to date. |

## Substantial Improvement in Debt Repayment Schedule

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| *Lucapa has three debt facilities outstanding* | 1. IDC of Sth Africa: ~US$5.5m, interest rate JIBAR plus 8.6%<br>2. Equigold: US$6.3m remaining, interest rate 13% p.a.<br>3. New Azilian: A$10m, interest rate 10% p.a. |
| *Some investors have been concerned about the repayment schedule* | As the Covid-19 pandemic began to take hold and the diamond production was suspended, a number of investors were expressing concern about the company's ability to meet the repayment schedule. Fortunately all three financiers understand mining and are supportive. Two of them also have sizeable equity positions in Lucapa. One of them is a non-executive director. |
| *Deferral of loan repayments* | All three financiers have pushed back the loan repayment schedule and suppliers have been supportive. Refer ASX announcement on 14 August 2020. |
| *IDC Loan* | **Original Terms**: Repayment of $0.77m per quarter, from Q1 2020<br>**Revised Terms:** Repayment and interest moratorium granted for 2020<br>**Security**: Mothae assets, mortgage over mining lease and 70% guarantee from Lucapa |
| *Equigold Loan* | **Original Terms**: Qtly repayments of US$0.94m<br>**Revised Terms**: 50% payment reduction, moratorium and interest rate reduction granted<br>**Security**: Lucapa's shares and loan to Mothae |
| *New Azilian Loan* | **Original Terms**: Repayment in August 2020<br>**Revised Terms:** Payment deferment and interest rate reduction granted<br>**Security**: Lucapa's assets, excluding interests in Mothae |

 

# Investment Highlights

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| *Lulo has been consistently improving over five years of operation* | The Lulo alluvial diamond mine has been characterised by five years of improvements in throughput and production, expanding resources and satisfactory dealings with the local partners and government bodies. Delivery on this level is unusual in the diamond sector as it tends to be dominated by over-optimism and promotion. |
| *Management capability and experience is a real positive* | The diamond industry is very specialised sector requiring first class management not just in the production process but also in the sales and marketing. The management team at Lucapa is amongst the highest quality available, with most of the key personnel having been employees of De Beers earlier in their careers. So far they have performed most credibly, giving us comfort that the Company is in good hands. |
| *A long life for the alluvial mine seems assured* | An analyst or investors with an ability to take into account geological potential will be able to look beyond the formality of alluvial JORC resources and see that there will a substantially longer mine life than published numbers would suggest. There is every reason to believe that Lucapa will regularly add to the resource base, thereby extending the mine life well beyond 10 years. |
| *Hard rock mine complements the alluvial operations* | Alluvial operations can be very profitable but grade can be more variable and the resources are less easily made JORC compliant. Recognising this, Lucapa acquired and developed the hard rock kimberlite mine with JORC resources and the confidence of a mine life extending beyond 10 years. It offers a second, balanced source of production and profits. |
| *Geopolitical diversification has lowered the risk profile, as has the regime change in Angola.* | Management was frequently reminded that Angola didn't have the best reputation amongst the international investors. Acquiring the Mothae project in Lesotho addressed these concern at the time, being a more highly preferred jurisdiction. As it turns out, the regime change in Angola has led to a positive re-rating of its investment rating. Lucapa has been a direct beneficiary of positive changes, hopefully with more to come. |
| *Main risk relates to diamond prices rather than operational issues* | Lucapa has demonstrated that it is an efficient producer of diamonds. The geological risk has been minimised through extended periods of production. Financing risk is minimal due all funds having been raised and loan repayments being met, with financiers wisely allowing to a restructuring of the repayment schedule. That leaves diamond prices as the area of greatest uncertainty right now, particularly because of the Covid-19 disruption. As with many other commodities that are suffering from a reduction in demand, there is also interruption to supply. We are still observing the markets to see what the net result will be. |
| *Earnings estimates point to strong fundamental value* | While 2020 is suffering some disruption, we estimate that subsequent years will be usefully profitable even on modest diamond prices. With estimated profits of $140m over the next 10 years, and the company's market capitalisation sitting at $45m, there is a disconnect between the share price and the underlying value of earnings. A PE ratio of 3-4x earnings is definitely not expensive. |
| *Cash receipts look even more attractive due to Lucapa being repaid loans* | Lucapa will benefit not only from earnings, but also from the repayment of loans exceeding A$80m. Thus, estimated cash receipts over the next 10 years amount to $217m, on our modelling. That places the shares on a cash generation multiple of a very low 2x. This suggests that the shares are very mispriced - on the low side - by the market at present. |
| *Don't forget about the potential beyond hard numbers* | The first point is that our numbers only look out 10 years ahead. There is no allowance for incremental value from the discovery and proving of expanded resources that could add to the mine life, both at the alluvial and the hard rock mines. |
| *The ultimate blue sky appeal of a new kimberlite pipe discovery is not priced in* | The big prize in most peoples eyes is the discovery of one or more kimberlite pipes from which the alluvial diamonds are sourced, in Angola. Lack of commercial success on this front so far should be seen as a delay rather than a failure as assessing targets is a process of elimination.<br>The discovery of a diamondiferous pipe could quickly make existing fundamental analysis redundant, leading to a new phase of speculative activity in the share market. It could be the real game changer. In the meantime, profitable mining operations will be able to fund the exploration program without constantly going back to shareholders for risk capital. |

 

# 1. The Lulo Alluvial Diamond Mine (40%)

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| *Into its sixth year of successful operation* | Any nervousness that early investors may have had about operating a diamond mine in Angola should be substantially reduced by now. There has been a consistency in fiscal conditions and the way the government has worked with the mine and the company. Geopolitical risk is perceived to be lower than it was five years ago. |
| *Regime change has been beneficial* | The mine has operated through a period of regime change without any adverse effects, and we have even seen changes in anti-corruption initiatives and diamond selling arrangements, which have been materially beneficial. |
| *Equity ownership is still on the table* | Investors have at times questioned the low level of ownership of the mine, with 40% equity being sub-optimal. The topic comes up for discussion from time to time with the government, but there has been no change as yet. Ownership of the operating alluvial mine is one matter. Equity in the kimberlite exploration licences and potential development is perhaps a more fluid position. At the moment there is little room to bring in major joint venture partners that might be needed for the development of a hard rock diamond mine, whilst leaving Lucapa with a meaningful stake in the venture. That position is under continual review and it remains a potential bullish point in favour of the Company. |
| *There has been a series of successful expansions of throughput* | Alluvial diamond mines are noted for the uncertainty of mine life with calculations of JORC compliant resources always a challenge. There is an element of serendipity involved. It is typical for a mine to start with small scale bulk sampling, with scale increasing over time until it morphs into a sizeable mine. Confidence grows over time and the expansions can often be financed by positive cash from operations. Such has been case at Lulo with the latest expansion increasing treatment capacity by >50% to >400,000 BCM p.a., financed by internal cash flow. |
| *Optimisation of recovery circuits* | Another feature of operational experience is the improving understanding of the material being processed, the type of diamonds being recovered and optimisation of final diamond recovery methodology. We have seen a number of changes/improvements at Lulo over time. |
| *The mine life at Lulo will always be understated due to reporting requirements* | While strict analysts will look to JORC resources and reserves to calculate mines lives, an understanding of the geology and the ground position at Lulo will encourage forward looking analysts to expect a mine life of at least 5-10 years from today. There may be variability in grades and quality from time to time, but experience to date gives comfort that such variability can be managed through mining of gravels from a number of locations to better manage variability. |

*Lulo Treatment Plant. Source: Lucapa presentation*

# 2. The Potential for an Economic Kimberlite Pipe (39%)

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| *Speculative appeal can be an early share price driver* | Even though a good alluvial mine can be very profitable there is a general perception that a hard rock kimberlite mine is more valuable. Speculation concerning the location of a kimberlite pipe can be a real share price driver, especially in the early phase of exploration when the concept is fresh. |
| *… but lack of instant gratification can lead to waning interest, then disinterest.* | Finding a source and building a diamond mine is exponentially more difficult than doing the same with a gold mine. Finding kimberlite is just the start of the journey. The majority of anomalies are not kimberlites and most kimberlites are not diamondiferous, so it may be necessary to test dozens of targets before a company gets any tangible encouragement. |
| *There are many steps in assessing the value of a diamondiferous kimberlite pipe* | Having identified anomalies an explorer will take samples of what appears to be kimberlitic material, both at surface and deeper, below any cover, to run tests to determine whether the geochemistry is favourable. If it is they then commence a program that involves ever increasing sample sizes in order to recover diamonds that can be assessed. The objective is to obtain at least a 10,000 carat sample to determine quality and value, whilst also assessing the distribution of diamonds and potential grades. Only then can a company start to assess preliminary economics. |
| *Following the trail of alluvials is a classic approach* | The best indicator of a diamond pipe is an alluvial diamond deposit that hold diamonds that have been eroded and transported by water action, to be trapped in gravels and potholes when the velocity of the water slows and allows diamonds to settle on riverbeds. Over many years, frequently millions, the water courses and geology will change location and diamondiferous gravels deposits may be buried by many meters of overburden. It is this type of deposit that is being mined at Lulo |
| *Inspection of diamonds will tell you how far they have travelled,*<br><br>*… and the Lulo diamonds haven't travelled far at all* | The size, shape and quality of diamonds will give clues as to how far the diamonds have travelled, and therefore indications of whether the source pipe is near or far. Lesser quality diamonds are worn away through the erosion and transportation events. The further the distance the less angular the diamonds become, and smaller.<br>The Lulo mine has recovered some amazing large angular diamonds. The expert advice is that they haven't travelled far and in all likelihood the source pipes could be on the leases held by Lucapa. The presence of many kimberlite pipes is supportive of this opinion, though which of these are diamondiferous is what the current exploration program is all about. |
| *Strong evidence that they may have come from the Canguige catchment area* | Lucapa has explored along the Cacuilo River finding diamonds along the way, with 45 diamond recovered at the mouth of the the Canguige River where it joins the Cacuilo River. This is only 3 km upstream from the Mining Block 46, which has produced high value and Type IIa diamonds of 88, 68, 60, 59, 35, 33, 32 and 31 carat sizes, along with fancy pink and yellow diamonds. The Canguige catchment area hosts 12 kimberlite pipes, five of which are regarded as high priority. |
| *Bulk testing on two pipes now, but the first one proved negative* | In the recent ASX announcements the Company has reported that the sampling of 2,511 $m^3$ from pipe L072 did not recover any diamonds. It is continuing with the testing of material from pipe L071 with material being being processed in the last week of August. Prior drilling confirmed these pipes had favourable mineral chemistry and their proximity to sealed roads enabled easy access, so they are the first two being tested. The other pipes will be tested subsequently.<br>The material being mined now is from the softer, near surface levels that do not require drilling and blasting. The existing treatment plant will be used to process these samples. |
| *No reason this diamond field isn't coming from a number of pipes* | Unfortunately L072 is not diamondiferous, so we wait to see what L701 returns. Irrespective of the results the exploration does not end there, or in the Canguige catchment area. Other tributaries to the Cacuilo River could also host diamond shedding pipes. Exploration will also be conducted in the near term on the Xangando and other drainage areas. Hopefully it is just a matter of time before the source is found. |
| *Location map* | Figure 1 over the page shows the location of the kimberlite pipes relative to the mining blocks. You can see that there are still a number of pipes to be tested. |

First bulk sampling site at Lulo kimberlite L071

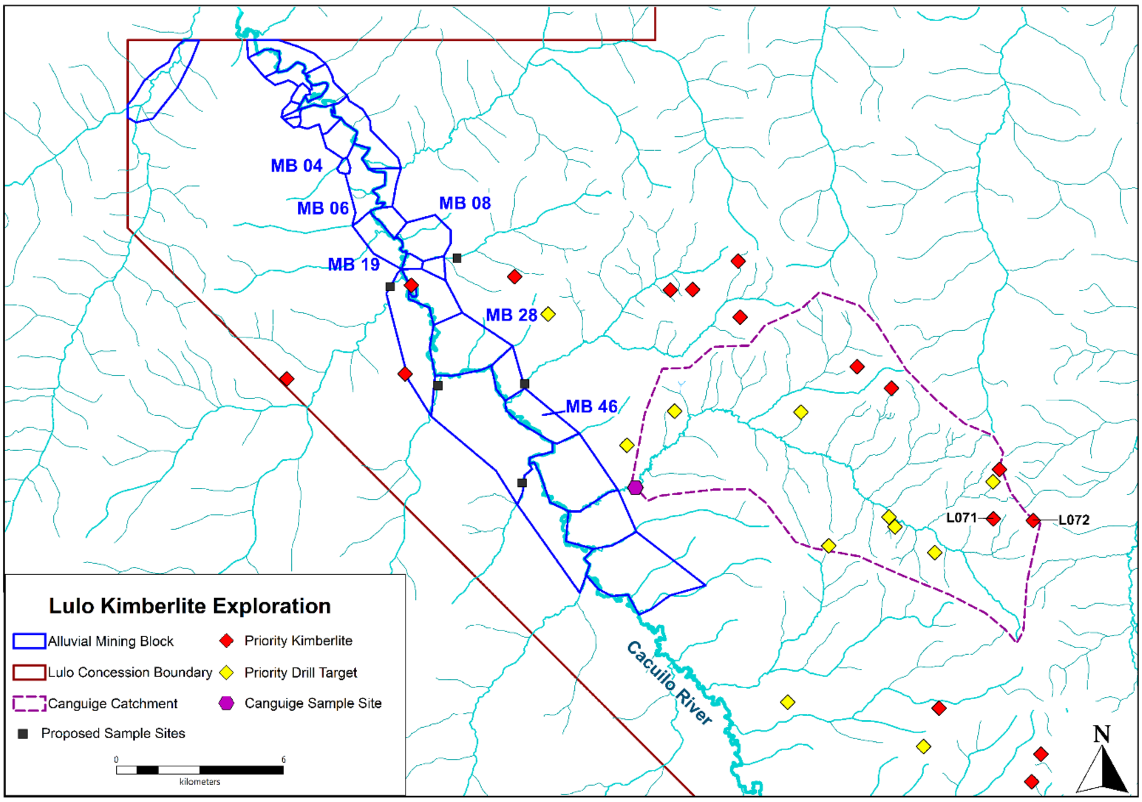


Figure 1: Location of the 16 Lulo kimberlite pipes rated most prospective to host diamonds, 8 additional anomalies to be drilled and the 6 tributary sampling sites

# 3. Mothae Kimberlite Diamond Mine

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| *Strategy was to diversify both geological and geopolitical risks* | When Lucapa's only producing asset was an alluvial diamond mine in Angola, it was considered by the stock market to be very high risk. Angola didn't have the best reputation for transparent government and the alluvial mine came with all the uncertainties for which those resources are usually well known. So, a value-adding producing asset was needed. |
| *So the high quality Mothae kimberlite project was purchased for US$9m* | Lucapa announced it was purchasing a 70% interest in the Mothae kimberlite project for US$9m, in January 2017. Key attractions of the project at the time were;<br>• a NI43-101 Indicated and Inferred Resource of one million carats<br>• location close to three other diamonds mines and only 5 km from Letseng, the world's highest value per carat kimberlite diamond mine<br>• trial mining had recovered large, premium-value and Type IIa stones and a low quality stone of 254 carats<br>• good infrastructure and a robust mining plan<br>• previous operators' expenditure of ~US$36m<br>• 10 year mining lease with a right for another 10 years |
| *Mothae hard rock mine bought on stream two years after purchase* | Lucapa arranged debt finance for Mothae late in 2017, and started to commission the Mothae diamond mine in late 2018, with first sales being achieved in Q4 2018. The mine progressively ramped up to name plate capacity in the June Half of 2019. |
| *Performance so far has been better than nameplate design* | The Mothae plant has been more efficient than designed, resulting in the recovery of diamonds smaller than 3mm. While this in incrementally beneficial, it has resulted in lower average diamond prices. Nevertheless, the gross revenue has been higher than otherwise would have been the case. |
| *Marketing proposal submitted to Lesotho Government* | Lucapa has submitted a marketing proposal to the Government that it believes will place the Mothae diamond mine in a good position to recommence production as soon as possible with certainty of diamonds sales, even in the troubled Covid-19 times. |
| *Offtake and cutting and polishing* | Lucapa has announced that it is talking to the Lesotho Government with respect to an offtake arrangement. If Mothae was to secure a minimum price for its diamonds, regular deliveries would provide a continuous cash flow and avoid the lumpiness of revenue when relying on time consuming tenders to secure sales. Given the cutting and polishing undertaken at Lulo and the last Mothae parcel, it is likely this would be furthered with the Mothae production as well. A few other diamond producers seem to following Lucapa's lead here. |
| *Compelling economics with a plant expansion* | Running of the numbers for a 60% expansion in capacity (see section below) gives a very positive outlook. Assumed expenditure of ~US$6m and a three to four month lead time could generate an additional ~US$10 - ~US$15m p.a. in EBITDA on average, providing a very short payback period on my assumptions. The numbers are compelling. |

***Mothae Treatment Plant. Source: Lucapa presentation***

# 4. Proposed 60% Expansion at Mothae

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| *Originally a two phase development plan* | The original plan for the development of Mothae involved a Phase 1 capacity of 1.1 Mtpa. A second, Phase 2 expansion to 2.2 Mtpa was planned for mid 2021, at a cost of ~US$50m. |
| *Optimised plan gives 60% capacity expansion for only US$6m.* | Armed with a two year operating experience at Mothae, and the knowledge that the existing plant can achieve a treatment rate of 1.2 Mtpa, Lucapa believes it can achieve a much more economic outcome by spending a fraction of that to lift capacity by 60%, effective in 2021. |
| *Operations will focus on the South Lobe* | Mining of the better grade South Lobe is expected to provide a good mine life. Assume at least 10 years, processing ~18 Mt of ore, at a resource grade of 2.7 cpht, to recover about ~500,000 carats. |
| *Capex at the front end of the plant* | The plan is to improve certain modules that have additional capacity constraints, such as the primary jaw crusher, secondary cone crusher and install a bypass conveyor. Capacity could be lifted to ~240/250 tph. |
| *Potential for US$350m revenue & US$150m EBITDA* | Using recent 2019/2020 diamond prices and factoring better economies of scale and source, it is possible that the mine could generate >US$350m of revenue to achieve EBITDA earnings of >US$150m over the 10 year life. |
| *Low waste to ore ratio* | A waste to ore ratio of approximately 1:1 is expected over my ~10 year life as the revised and lower throughput of 1.8 Mtpa (vs 2.2 Mtpa) is expected to give a lower stripping ratio and more optimal mine plan. There is substantial resource remaining at depth in the South Lobe as per previous announcements on possible mine life extensions at Mothae. |
| *Mine life will be much more than 11 years* | Apart from the targeted South Lobe, the Neck and the North Lobes provide the potential for additional ore. These locations need further drilling, sampling and assessing before being brought into the mine plan. It may be that these are lower grade but we cannot be definitive yet. |
| *Indicated and Inferred Resources total 38 Mt* | Lucapa has quoted a resource of 38 Mt to a depth of 300m, though most of this is still in the Inferred category. We should be expecting a restatement of this some time this year, with a larger proportion falling into the Indicated category. This tonnage suggests a probable longer mine life than my estimated minimum of 10 years. |
| *Pipe extends to 500m depth* | The pipe has been modelled to a vertical depth of 500m, which is 200m deeper than the resource base in the JORC resource statement. Depending upon the economics of the day, this additional material could add another 10 years to the mine life. |

 

# Revised Earnings Model

| | The World Has Changed over the last 12 Months |
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| *In May 2019, it was all about expansion and commissioning of two mines …* | The last time we ran the earnings model, in May 2019, the Company was starting to commission the new mining fleet at the Lulo alluvial mine and it was anticipating improved volumes and economics. The Mothae hard rock mine was continuing through the ramp-up phase and we were still trying to correlate resource expectations with actual performance. |
| *… but then along came the virus and greatly increased uncertainty* | The coronavirus has suddenly introduced a dramatically different global environment in all aspects of our lives, be it economics, business, operational or social. Everything is different and we are still struggling to understand how it will pan out, both in the short term and the long. |
| *Revised numbers have increased conservatism* | Our revised earnings model has the benefit of another 12 months of operations, so in theory there should be greater confidence, but in reality the uncertainties introduced by the virus have imposed greater caution and conservatism. The base case is less expansive than what would previously been been estimated. |
| *Focusing on 2021 & 2022 years* | We have focused on the next two calendar years rather than worrying too much about 2020, which is already an extraordinarily difficult year in the diamond industry and will not be indicative of what we expect going forward. |
| *With life of mine summary columns* | Just focusing on the next three years of operation gives a timely view of what the Company is likely to achieve in the immediate future, but the full value of its projects is best achieved by looking at the estimated life of mine totals, which appear in the left hand column of the model. These totals should be placed in perspective with the market capitalisation of Lucapa, which is in the order of A$45m, and the outstanding debt position of approximately A$26m. |
| *Projects owe Lucapa US$60m plus interest* | An important value item for Lucapa is the US$60m of project debt that will be repaid back by the two operations to Lucapa over the next few years. Thus it is not just about operating profits, but also about cash returning to the Company. |

| | Changes to the Lulo Alluvial Mine Estimate Parameters for 2021 & 2022 | |
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| | **Previous** | **Revised** |
| *Throughput of gravels* | 450,000 BCM | 425,000 BCM |
| *Recovered Grade* | 10 ct/100m$^3$ | 7.8 ct/100m$^3$ |
| *Carats Recovered* | 45,000 cts p.a. | 33,000 cts and 36,000 cts |
| *Operating Costs* | US$61.50/BCM | US$63.00/BCM |
| *Diamond Values* | US$1,750/ct | US$1,528/ct |

 

# Lucapa Earning Estimates

## Notes on Earnings and Cash Flow Model

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| ***Lulo Alluvials (40%)*** | |
| *Throughput* | Steady state throughput has been assumed at 425,000 BCM p.a., though the existing equipment could comfortably achieve 450,000 BCM. No expansion has been assumed, though it is possible. The 2020 year has been interrupted by Covid-19, so throughput has been reduced to 350,000 BCM. |
| *Operating costs* | Assumed to fall from US$81/bcm in 2019, to US$63/bcm following the expansion. Fixed costs assumed to constitute 65% of costs, and variable costs 35%. |
| *Recovered Grade* | Based on the average of the resource statement |
| *Selling price* | Based on prices received to date in 2020, that take into account the disruption caused by Covid-19 to selling methodology and prices. From 2022 onwards there has been a one-off 5% escalation assumed. |
| *Depreciation* | Using straight-line method over 10 years of an estimated US$60m investment in development. |
| *Royalty and marketing* | 5% royalty on alluvial diamonds, to the government and 5% sales/marketing commission. |
| *Corporate income tax* | 25%. In tax paying position now. |
| *Loan Repayment* | 50% of free cash flow goes to repaying the US$30m loan owed to Lucapa, received in the subsequent year. Non interesting bearing. |
| *Dividends from SML* | 50% of free cash flow, with Lucapa receiving 40% of this payment |
| *Withholding tax* | 15% rate on dividends remitted to Australia |
| *Capital Expenditure* | Minimal capex is expected, following the US$12m expansion undertaken in 2019. Assumed US$5m p.a. in in 2021 and 2022, for in-field screening equipment. Thereafter, US$2.5m p.a. |

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| ***Mothae Kimberlite (70%)*** | |
| *2020 operating year* | Excluded numbers for this year due to Covid-19 - care and maintenance |
| *Expansion  from 2021* | Assumed the expansion from 1.1 Mtpa is commissioned, taking capacity to 1.8 Mtpa |
| *Funding has to be arranged* | The expansion will cost an estimated US$6m which has to come from external sources. A number of alternatives are under consideration. |
| *Operating costs* | w:o almost zero in 2021, 1.5:1 in 2022 and 2:1 in 2023 for early pre-stripping. The life of mine assumed ratio is 1:1. Mining of ore and waste US$2.25 pt, treatment US$4 pt and overheads US$2.50 pt. |
| *Recovered Grade* | Based on the average of the resource statement |
| *Selling price* | Based on South Lobe diamonds which are higher value. Company gave a range of US$600-750/ct. We have assumed US$700/ct in 2021, rising by 5% in 2022. |
| *Depreciation* | Taking value in annual report, adding the expansion and depreciating over 10 year life |
| *Royalty and marketing* | 5% royalty on alluvial diamonds, to the government and 1.5% sales/marketing commission. |
| *Corporate income tax* | Tax credits from acquisition and development capex carried forward so assuming no tax for first four years |
| *Loan Repayment* | $30m owed by project to Lucapa |
| *Dividends to LOM* | 70% of free cash flow net withholding tax, Loans to be repaid first as they attract no WHT |
| *Withholding tax* | 25% rate on dividends remitted to Australia |
| *Capital Expenditure* | US$6m for expansion to 1.8 Mtpa, then 2% p.a. of opex as sustaining capital |

 

# Lucapa Earning Estimates - Resources & Production Summary

| Key Assumptions | Lulo | Mothae |
|---|---|---|
| Project Equity | 40% | 70% |
| Exchange Rate (AUD/USD) | 0.72 | 0.72 |
| Tax Rate | 25% | 25% |
| Withholding Tax | 15% | 25% |
| Royalty | 5% | 5% |
| Waste:Ore Ratio | 10:1 | 1:1 |
| Description | gravel beds | hard rock |
| Thickness | 15cm - 2m | |
| Mimimum Mining Height | 45 cm | |

| Reserves and Resources - Lulo | | |
|---|---|---|
| Inferred Resource | BCM | 1,151,200 |
| Diluted Grade | cphm³ | 8.75 |
| Carats in Resource | carats | 100,700 |
| Modelled Value | US$/ct | $1,620 |
| In-Situ Value | US$m | $163m |
| Mine Life (earnings modelled on 10 yrs) | Years | 3.5 |

| Reserves and Resources - Mothae | Mt | Grade | Carats | Value US$/ct |
|---|---|---|---|---|
| Indicated Resource | 1.87 | 2.9 cpht | 0.05 mill. | $1,146 |
| Inferred Resource | 36.2 | 2.7 cpht | 0.98 mill. | $1,053 |
| Total Indicted and Inferred | 38.1 | 2.7 cpht | 1.03 mill. | $1,059 |
| In-Situ Value US$m | $109.3m | | | |
| Mine Life years | 10 | | | |

| Production Profile | | Life of Mine | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| | | | | | | |
| **Lulo Alluvials** (LOM 40%) | | | | | | |
| Gravels Processed | 000 BCM | 4,175 | 350 | 425 | 425 | 425 |
| Grade | cphm³ | | 7.8 | 7.8 | 7.8 | 7.8 |
| Carats Produced | ct | 326,000 | 27,300 | 33,150 | 33,150 | 33,150 |
| Value | US$/ct | $520.0m | $1,528 | $1,528 | $1,604 | $1,604 |
| Operating Costs | US$/BCM | | $63.00 | $63.00 | $63.00 | $63.00 |
| | | | | | | |
| **Mothae Kimberlite** (LOM 70%) | | | | | | |
| Ore Processed | 000 t | 17.6 Mt | - | 1,760 | 1,760 | 1,760 |
| Recovered Grade | cpht | | - | 2.7 | 2.7 | 2.7 |
| Carats Produced | ct p.a. | 475,200 | - | 47,520 | 47,520 | 47,520 |
| Value | US$/ct | $350.0m | - | $700 | $735 | $735 |
| Operating Costs | US$/t | | - | $9.20 | $12.13 | $13.25 |

# Lucapa Earning Estimates - Financials

Rather than present the detailed model in this note we have extracted a summary of the Net Profits and Cash Returns to Lucapa: the essence of why we like the Company. These are tabled below.

On an estimated Net Profit basis, assuming a 10 year life for both projects, and the shares selling at 7¢ in the market;

- ✓ the shares are heavily discounted with the value of earnings stream currently 3.1x the current share price (undiscounted).
- ✓ a typical PE ratio from 2021 onwards is 3-4x (on an annual basis).

On a Cash Flow basis the shares look even better value.

- ✓ the shares are heavily discounted with the value of cash flow stream currently 4.8x the current share price (undiscounted).
- ✓ a typical Cash Flow Multiple ratio from 2021 onwards is 2.2x.

| Project Earnings and Cashflow | | Life of Mine | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| | | 10 years | Estimate | Estimate | Estimate | Estimate |
| **Lulo** (100% equity) | | | | | | |
| Operating Margin (EBITDA) | | $225.0m | $17.2m | $20.6m | $22.9m | $22.8m |
| Net Profit (post tax) | | $124.0m | $8.4m | $10.9m | $12.6m | $12.6m |
| Lucapa Equity (40%) | US$m | $49.4m | $3.4m | $4.4m | $5.0m | $5.0m |
| | A$m | $68.6m | $4.7m | $6.1m | $7.0m | $7.0m |
| LOM Cash Receipts (incl. loans) | US$m | $75.0m | $0.0m | $9.0m | $8.0m | $9.1m |
| | A$m | $104.2m | $0.0m | $12.5m | $11.1m | $12.6m |
| | | | | | | |
| **Mothae** (100% equity) | | | | | | |
| Operating Margin (EBITDA) | | $133.0m | - | $15.1m | $12.4m | $11.6m |
| Net Profit (post tax) | | $73.0m | - | $8.1m | $5.2m | $4.9m |
| Lucapa Equity (70%) | US$m | $51.1m | - | $5.7m | $3.6m | $3.4m |
| | A$m | $71.0m | - | $7.9m | $5.1m | $4.8m |
| LOM Cash Receipts (incl. loans) | US$m | $81.5m | - | $6.0m | $8.8m | $6.3m |
| | A$m | $113.2m | - | $8.3m | $12.2m | $8.8m |

| Company Earnings and Cashflow | | Life of Mine | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| | | 10 years | Estimate | Estimate | Estimate | Estimate |
| | | | | | | |
| **Net Profit** | **A$m** | $139.6m | $4.7m | $14.0m | $12.1m | $11.8m |
| Per Share (641 mill. fp) | | 21.8¢ | 0.7¢ | 2.2¢ | 1.9¢ | 1.8¢ |
| Multiple of Current Share Price (7¢) | | 3.1x | | | | |
| PE | | | 9.5x | 3.2x | 3.7x | 3.8x |
| | | | | | | |
| **Cash Receipts** | **A$m** | $217.4m | - | $20.8m | $23.3m | $21.4m |
| Per Share (641 mill. fp) | | 33.9¢ | - | 3.2¢ | 3.6¢ | 3.3¢ |
| Multiple of Current Share Price (7¢) | | 4.8x | | | | |
| Cash Flow Multiple (annualised) | | | - | 2.2x | 1.9x | 2.1x |

*Note: The detailed model may be made available from the author, on request.*