



In Depth with Stephen Wetherall CEO OF LUCAPA DIAMOND CO.

CEO of Australia's Lucapa Diamond Company, Stephen Wetherall, paid a visit to Antwerp recently, where The Diamond Loupe caught up with him. We encountered an optimistic CEO that is clearly excited about the future of Lucapa, and justifiably so. The growing miner operates, together with its partners in Angola, the highest-value and most promising alluvial diamond project in the world - the Lulo Diamond Project. Their Mothae mine in Lesotho will commence production in a matter of weeks, their Brooking Diamond Project in Australia has delivered hugely promising early returns and they hope to find diamondiferous kimberlites at their 100%-owned Orapa concession in Botswana. We discussed Angola's new Diamond Trading Policy, the start of production at Mothae and the decision to market those goods in Antwerp.

The Diamond Loupe: Angola recently introduced what the country calls "a profound reform" in its mineral resource sector and diamond marketing policy. What are the key issues this policy addresses, and are the changes going to open up your market?

Stephen Wetherall: I believe they will. The changes being made are significant. The main reason they are being implemented is to drive inward investment. Angola wants to grow its mining sector, particularly in diamonds. The key objective of the new policy is indeed to implement major reform, to improve the attractiveness and competitiveness of the national diamond industry and grow outside investment into Angola, so mining contributes more to the Angolan fiscus.

More specifically, the policy intends to achieve this growth by establishing an effective system to ensure greater transparency and predictability in the rough buying and selling process, in order to maximize value and price stability. It is also designed to increase control and simplify revenue collection to ensure the government realizes the optimal value from its resources. They will standardize price setting and implement international models for rough diamond sales, such as sights

or preferred clients, spot sales or seasonal clients, and conduct tenders or auctions. And they will promote cutting and polishing in the country, as well as the internal jewelry market. In summary, they are evidencing to the world that this new marketing policy will safeguard the legitimate interests of producers, introduce a more transparent way of valuing the product, and will bring in multiple better sales channels through which the miners can access a fair market price.



"IF YOU WAIT UNTIL TOMORROW, YOU MIGHT BE TOO LATE."

The DL: What sort of benefits do you expect to derive from the policy as a company operating in Angola? Do you anticipate systematic changes will be felt immediately?

SW: The changes will be quite significant for diamond mining companies in Angola. Once the technical regulations for the new diamond marketing policy are gazetted and in force - which is

expected at the end of October or early November - producers will likely have the ability to determine which new channels the majority of their product is sold through, and to which buyers.

This 'majority' has been said to be up to 60% of production and the ability to use multiple competitive channels for price discovery will result in producers achieving international market prices.

The DL: Some people will say they have heard this all before, and nothing will change. Do you think it will take some time before investors regain confidence in Angola?

SW: Our company has been there since 2007. I have been with this company for four years. The previous company I was working with (Gem Diamonds) also had projects in Angola. So, we have a lot of experience there. I am on the ground and I see the changes they have been making and the efforts being made to do that. The ability to own majority stakes in new developments and new projects is a major step. It has generated a huge amount of interest from international mining companies,

and it is going to happen. If you wait until tomorrow, you might be too late.

I know people may be skeptical, saying they have heard it all before, but I see it happening. I am on the inside, I see what is changing, and I see real change happening. It gives me a lot of excitement and I am very optimistic. Obviously, there were previous impediments in Angola to doing business, driving investment and perhaps achieving the best price for

your product. But we are excited about the new channels opening up because we believe we can drive better prices and everyone will gain. Angola will gain higher royalties, higher taxes, reinvestment into projects, more employment, indirect taxation and so forth. All of this will help grow their revenue base, and that is what I see happening. In short, I believe the changes will be felt quite quickly.

The DL: How do you plan to conduct your diamond sales under the new policy?

SW: There are many different means to achieve better prices. Conducting tenders or auctions is one such means, with Lulo inviting as many buyers as possible to view its production and let them bid in a competitive environment. As I mentioned, we have to wait for the technical regulations to be published later this year. And, of course, Sodiam will still be involved. It might be a slightly different structure, but the government still needs to control the flow of diamonds, record the diamonds, manage the KP certification process as well as the export of diamonds. Sodiam will still perform those functions. But as I mentioned, up to 60% of product from the miners should go to channels they believe are most suitable.

Since about the beginning of 2015, we have sold Lulo's regular production to a few buyers. Sodiam arranged the buying and we negotiated the price with the buyer. It was on a willing buyer/willing seller arrangement. Given the limited buying pool available



in Angola and the fact that they went through a single channel, we did not really achieve the highest market price, so the new channels are significant in terms of price discovery. We will be able to invite buyers in and run tenders and/or auctions either with or through Sodiam. We are not sure how that is

going to work just yet, so we eagerly wait for the technical regulations.

The question many people have been asking me is, "Will you be able to sell your goods outside Angola?" The answer is that I am not sure what is going to be legislated. Antwerp is

making a huge play in terms of being the main jurisdiction for Angolan goods to come through, which is great because it also supports our objective of getting the highest price for our goods, so it is very good to work with the AWDC and Antwerp in that regard.

SEARCH FOR THE SOURCE AT LULO

The DL: Concerning your search for the kimberlite source of Lulo's large and high-quality alluvial diamonds. Is it a situation where you can say, given certain indicators, you are getting close?

SW: The honest answer is, if we knew, we would have it. But certainly, regarding the indicators you mention, they are really exciting and off the charts compared to other exploration projects. Take our early stage Orapa project in Botswana: we have done work to identify kimberlite targets and are going to drill those later this

year/early next year. We hope they will return kimberlite, but will it be diamondiferous? We do not know that yet. We are not recovering diamonds over the top of them like we are at Lulo. I am looking for a kimberlite at Orapa, but I don't have any diamonds to excite me about it.

The situation at Lulo is very different. What if I were to say to you that on top of that anomaly I am about to drill, I have recovered a 404-carat stone, 227-carat, 173-carat? We have recovered approximately 800 diamonds of +10.8 carats and above on top of our kimberlite targets at Lulo. So, what are the chances of the kimberlites being diamondiferous? Very, very good. The other anomaly at Lulo, when compared to any other project, is that we do not have one or two 'pings' across a huge area. There is not just one target below these magnificent alluvial fields, we have 300 pings. Therein lies our work to be done.

The other thing I should mention is that these heavy stones should not travel very far in a transport erosion process. If we are finding lots of little rounded stones like they do off the coast of Namibia, they may have travelled a few hundred if not thousands of kilometers. But we are finding heavy matter, and in a water-borne transport process, that drops out first. We also recovered a 133-carat compound diamond. It is made up of lots of little diamonds joined together. If that had traveled in an aggressive transport erosion process for some time, it would have broken up into lots of little pieces. The big stones we are pulling up, just about every other day and a half, have no signs of abrasion, no signs of transport, and no rounded edges. They cannot have traveled very far. This gives us a lot of excitement that we are digging and drilling in the right areas. We just have to go through those 300 pings. Some will be good and some will be barren.





The DL: If you find it, what would that mean for Lucapa?

SW: It would mean a different valuation for us as a company. If we put the hole in the source there, it will be one of the most special mines in the world, if not the most special mine in the world. When you look at the grades we are getting from our alluvial goods and the

value of the product we are getting, the source can only be very special. That is what we are looking for. If we are successful, there will be a significant re-rating for us as a company. The nice thing about it as well is that the returns we are making off of the alluvial

operation means I am not constantly asking shareholders to commit their funds. We are using the returns from our alluvial operations to drive our kimberlite exploration program.

The DL: Are you searching for additional projects at this point?

SW: The current projects we have in our portfolio are very good. We have not yet found projects that would be more exciting than us spending our money on Lulo, Mothae and Brooking in Australia. Our internal management teams are heavily focused on those, so additional projects are probably

a little difficult for us to take on right now. Having said that, we are a growing company. As soon as I see we have the capacity to actively start looking at other projects, we will most certainly do so. Angola is, along with Canada, considered one of two countries where a Tier 1 discovery is likely, and there

is a huge potential for exploration. We are currently in the process of reviewing the alluvial exploration program with our Lulo partners with the aim of expanding it for 2019, and have already procured additional auger capability to test the flood plains for an additional alluvial resource.



MOTHAE MINE ON SCHEDULE, PRODUCTION HEADED TO ANTWERP

The DL: Moving on to the Mothae mine ... There was skepticism in the industry about it turning into much, but it seems like you have quickly obtained better results than expected.

SW: If you talk to diamond experts, the guys that are on the ground and do the work, Mothae is a very special pipe. It is a low-grade, high-dollar per carat environment, like Gem Diamonds' Letšeng mine, and like our Lulo. Huge volumes of ore are needed to assess the potential in the ground. Lucara committed to that program and were halfway through - they were up to 600,000 tons into a million-ton program. But at the same time, they started discussing with African Diamonds to acquire AK6, which has become Karowe. That was a bigger

pipe than Mothae. They needed money to fund it, decided there was greater scope in Karowe and went and developed that. Look what it has become. Great decision. No two ways about it. But that left Mothae lingering for others to consider, and it is a great resource.

At the time Lucara assessed Mothae, it was probably not as economically viable as it is now, but some of this had to do with local currency impact. The Lesotho loti is pegged to the South African rand on a 1:1 basis, and

the devaluation of the local currency has made the project considerably more economic in our assessment. The other thing that likely frightened Lucara in terms of its development is that they were considering a 2.6-billion rand build, or almost \$300 million development at then exchange rates. We are not doing a \$300m development. We are doing a phased development, we are going to gain confidence from a smaller Phase one, where we will show investors its merits and then we will double up and grow it further.

The DL: Lucapa said last June that construction of the new, 150-tonne per hour plant at Mothae was on schedule for commissioning in the second half of the year. Are you still on target?



SW: Absolutely. Mothae is well on track to commence commissioning of the main modules of the 1.1 million tonne per annum treatment plant. This will see Mothae ramp the tonnage up progressively to 90,000 tons per month over the fourth quarter of 2018 and be in a position to treat 1.1 million tons for 2019. We told the market we would start commissioning in Q4, but it will be early Q4. We are going to start turning the drives in a couple of days, and I look forward to some ore going through in the next few weeks.

The DL: And you are thinking 2020 for phase two?

SW: Correct. We will operate Phase one for three and a half years. Once Phase one is done we will invest in a Phase two study, but really it is all about the double-up. 2020-2021 is scheduled

for Phase two. But if it starts producing results as soon as we turn it on next month, why wait until 2020? If it is producing the results and the margins are there, the faster you ramp it up,

the quicker you can bring the returns forward. We have built in some time for assessment, but we can accelerate that.

The DL: The first parcel of 2,500 carats from Mothae was sent to Antwerp for cleaning and valuation. Do you plan to market your goods in Antwerp?

SW: Yes. We are very excited that the Mothae mine has exported its first parcel of bulk sample diamonds for cleaning, valuation and ultimately sale. It must be noted that these diamonds

have been sourced from areas of the kimberlite that were not previously well-sampled or not sampled at all.

Lucapa, in conjunction with its Lesotho

government partners, invited a number of proposals from diamond marketing agents in terms of how to market and where to market the Mothae product. At this point in time, after detailed





review, Mothae decided to send its diamonds to Antwerp for sale.

The board considered a number of points before deciding to market its product in Antwerp. Is the diamond centre well-established? Are there a number of established and competing tender houses, with solid reputations and viewing facilities? And, of course, the clients. Will the right clients see the product? Is the jurisdiction open to buyers from all countries where demand for rough diamonds is high? How strong is its fiscal control

measures? Are there established anti-money laundering regulations and established banking systems? How has the jurisdiction stood up to all types of markets, when it is strong as well as weak? And very importantly, does it have sufficient access to peripheral diamond services such as cleaning, diamond study and evaluation technologies and, given future marketing strategies, outsourced cutting facilities - especially high-end.

The board was satisfied that Antwerp ticked all of these boxes. And the

buyers that come to Antwerp know the Lesotho production because the other three mines operating in Lesotho send their product here. When a new mine comes on-stream, buyers are usually a bit hesitant on the product. They need a couple of months to see how your product will be manufactured and the values that are derived from it. Do they see in the rough what they get in the polished? With a knowledgeable buying base that knows Lesotho product, you might shorten that assessment time and get a price much sooner in that learning cycle.

"DO YOUR OWN WORK."

The DL: At the Brooking Project in Australia, you recently had an amazing result at Little Spring Creek. Did that surprise you?

SW: Absolutely. The work done by the previous companies and our confirmatory sampling gave us the confidence to invest in the project. The three geologists that brought the project to us and showed us what had been done, are still our active partners. The micro-diamond recoveries from the areas that had been tested gave us

excitement, but in the diamond game, you don't trust everybody. An old boss of mine said, "Always, do your own work" in the diamond space. With that in mind, I sent our own teams up there. We did our own work and repeated those recoveries. We then signed the commercial agreement to acquire 80% of the project.

We were expecting diamonds at Little Spring Creek (LSC), but we were not expecting 119 micro and macro diamonds in the first 78 kg of drill core. A very exciting recovery. We then did some more ground work, defining the signature of the anomaly more clearly, moved the drill program more toward the center of that anomaly, and



recovered 1,100 micro-diamonds in 178 kg of core. Fantastic results. LSC is not a huge pipe, but it is exciting enough. We are going to be trenching it pretty shortly and taking a bulk sample.

We will send that ore to a laboratory in Perth to recover diamonds right down to the smallest fractions. We have work to do, we have fantastic results, but we are looking forward to this next drilling

and trenching program. We will have lots of results to come to market in the next 2-3 months.

The DL: Final question. In Lucapa's presentation from the Africa Down Under Conference in August, I see that your value chain stretches into cutting and polishing. Could you tell us about that?



We are trying to see if we can partner with some high-end diamantaires, which is something I did when I was with Gem Diamonds. It is attractive for a partner because they are not competing with anyone else on a tender to get access to your goods. It is a win-win relationship. There is no arguing over the price of the rough and we share the reward, as well as the risk, from the final product. It is also a protective strategy. If you set a good reserve price on your diamonds and you understand the value of the product as polished, you can set a good strong rough price. If it is not achieved, don't sell your diamond. Why sell it if you believe it has more value? Don't sell it, but partner with someone on it.

I love that part of it. I did not really love the diamond space until I got into marketing the diamonds. When you are in the group finance team or are assessing projects, it is all at a distance, looking at modeling, etc. But when you see the rough product, feel it and fall in love with it, and then you sell it and see what happens to it afterward as it moves through the value chain, that is when the industry really grabbed me. I really enjoy it.

Look at the direction things are moving today, with Gen Z and the millennials placing importance on provenance and the story of how a diamond has come to market. If you create a link with a high-end retailer, you can go right back to the day it was found, to the blast that liberated it from the earth, right through to when it is in the ring. You can create the full story for the buyers who are demanding that as a consumer. How do you create that story? There are loads of opportunities for us as a company, and I want to explore them.

SW: There are two aspects as to why a miner would want to go that route: to attract the highest value and to mitigate the risk we take in developing a mine. We take an enormous risk in trying to find a resource, in evaluating that resource and building a mine to extract value out of the ground. We then sell a stone to someone that only takes a risk at that point when they buy it. I am not saying the price is right or wrong, as they have to calculate their own risks in terms of manufacturing

it, and whether they can move it. How long will they have to hold it in inventory, and so forth. But when you have very special product like we do at Lulo and Mothae, and you see what happens to those stones down the line and the value that is accreted on the jewelry and polished stones - it would be wrong of me not to assess whether we can recuperate some of that value for our projects. That is what we are trying to do.

Photos courtesy of
Lucapa Diamond Company.

