LUCARA
DIAMOND

Management's Discussion and Analysis

and

Condensed Interim Consolidated Financial Statements

For the Three and Six Months ended June 30, 2020

(Unaudited)

# LUCARA DIAMOND CORP.
# MANAGEMENT'S DISCUSSION AND ANALYSIS
# JUNE 30, 2020

Management's discussion and analysis ("MD&A") focuses on significant factors that have affected the performance of Lucara Diamond Corp. and its subsidiaries (the "Company") and such factors that may affect its future performance. In order to better understand the MD&A, it should be read in conjunction with the unaudited condensed interim consolidated financial statements of the Company for the period ended June 30, 2020, which are prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") as applicable to interim financial reporting. All amounts are expressed in U.S. dollars unless otherwise indicated.

Disclosure of a scientific or technical nature in the MD&A was prepared under the supervision of Dr. John P. Armstrong (Ph.D., P.Geol.), Lucara's Vice-President, Technical Services and a Qualified Person, as that term is defined in National Instrument 43-101.

Some of the statements in this MD&A are forward-looking statements that are subject to risk factors set out in the cautionary note contained herein. Additional information about the Company and its business activities is available on SEDAR at www.sedar.com.

The effective date of this MD&A is August 10, 2020.

## ABOUT LUCARA

Lucara is a leading independent producer of large exceptional quality Type IIa diamonds from its 100% owned Karowe Diamond Mine in Botswana. The Karowe Mine has been in production since 2012 and is the focus of the Company's operations, development, and exploration activities. Clara Diamond Solutions Limited Partnership, a wholly-owned subsidiary of Lucara, has developed a secure, digital sales platform that uses proprietary analytics together with cloud and blockchain technologies to modernize the existing diamond supply chain, driving efficiencies, unlocking value and ensuring diamond provenance from mine to finger. Lucara has an experienced board and management team with extensive diamond development and operations expertise. Lucara and its subsidiaries operate transparently and in accordance with international best practices in the areas of sustainability, health and safety, environment, and community relations.

The Company's corporate offices are located in Vancouver, Canada and London, England and its common shares trade on the Toronto Stock Exchange, the Nasdaq Stockholm Exchange in Sweden and the Botswana Stock Exchange under the symbol "LUC".

## RECENT DEVELOPMENTS

Karowe's large, high value diamonds have historically accounted for approximately 70% of Lucara's annual revenues. Though the mine has remained fully operational throughout the COVID-19 pandemic, Lucara made a deliberate decision not to tender any of its +10.8 carat production after early March 2020 amidst the uncertainty caused by the global crisis. Subsequently, in July 2020, Lucara announced a ground breaking partnership agreement with the HB Group headquartered in Antwerp, Belgium ("HB"), entering into a definitive supply agreement for the remainder of 2020, for all of the diamonds produced in excess of +10.8 carats from our 100% owned Karowe Diamond mine in Botswana. Under the supply agreement with HB, Lucara's +10.8 carat production will be sold at prices based on the estimated polished outcome of each diamond, determined through state of the art scanning and planning technology, with a true up paid on actual achieved polished sales thereafter, less a fee and the cost of manufacturing. This unique pricing mechanism is expected to deliver regular cash flow for this important segment of our production profile at superior prices. The Company will start recognizing revenue from this sales agreement inclusive of the production from the +10.8 carat stones that would have ordinarily been part of the Q2 tender in the third quarter this year. As of June 30, 2020, the Company received a deposit of $13.5 million as partial payment for +10.8 carat goods delivered under the new sales agreement. This deposit has been recognized as deferred revenue and will be brought into income as the polished diamonds are sold. Quarterly revenue of $7.5 million for the three months ended June 30, 2020 includes only proceeds from the sale of diamonds smaller than 10.8 carats that were sold on Clara or through the re-scoped Q2 tender. As a result, revenue recognized in Q2 2020 is materially lower than previous quarters.

Travel restrictions in response to COVID-19 continue, impacting the Company's ability to complete tenders in Botswana. As a temporary measure, the Government of Botswana has granted Lucara permission to hold diamond sales in Antwerp. Lucara completed its rescheduled Q2 tender on June 18th in Antwerp, Belgium, selling diamonds in size classes below 10.8 carats and achieving sales prices within 5% of forecast. Diamonds that are suitable continue to be re-directed from the tender offering for sale through Clara, the digital sales platform that allows buyers to place orders without physically viewing the goods and to purchase only the diamonds they need on a stone by stone basis.

Sales of stones between 1 and 10 carats have continued on Clara, with five sales taking place on Clara during the second quarter of 2020. Since the beginning of 2020, Clara's customer base has increased from 27 to 46 buyers. Discussions continue with third parties to grow supply on Clara to match demand from the larger customer base. We anticipate starting trials of third party diamonds during the third quarter.

**UPDATE ON COVID-19 RESPONSE**

In response to the COVID-19 pandemic, the Company implemented its crisis management strategy in March of this year, designed to protect the health and well-being of our employees in Botswana and Canada as well as the financial well-being of the business. The Karowe Mine remains fully operational under new measures and guidelines implemented by the Government of Botswana in late March 2020. These measures designated mining as an essential service in Botswana and included increased travel restrictions, reduced overall staffing levels and increased and appropriate social distancing. A strong operating environment continued at the Karowe Mine with Q2 delivering operating results consistent with the original 2020 plan and costs achieved below budget. The full impact of COVID-19 on Lucara's operations and production outlook for 2020 remains highly uncertain, and as a result, the Company is maintaining the suspension of its 2020 guidance until further notice.

Lucara's planned capital spending program for 2020 was to be largely focused on the initiation of an underground expansion project at Karowe and funded entirely from free cash flow generated by operations. Although the recently announced supply agreement with HB is expected to provide regular monthly cash flow for the remainder of the year, some uncertainty remains around estimating revenue for that period. As a result, the underground expansion program has been re-scoped and reduced from the previous budget of $53 million and will focus on long lead time critical-path items through the remainder of the year. The underground expansion program, as previously announced, has an estimated capital cost of $514 million and a five year period of development, with flexibility to adjust capital spending depending on market conditions. The Company expects to finance part of the capital cost with debt and the balance from cash flow generated from operations.

The Company continues to have a strong availability of working capital, including $13.7 million in cash at the end of Q2 and $31 million available from its revolving term working capital facility with the Bank of Nova Scotia. The $50 million credit facility was extended to May 5, 2021 during the second quarter of 2020. As part of the extension, and until Lucara obtains greater clarity on its cash flow projections in the short-term, Lucara has agreed to limit capital expenditures related to the underground expansion project. The extension of this facility provides an important source of liquidity to Lucara during a period of significant uncertainty in global markets.

**HIGHLIGHTS – Q2 2020**

- Karowe has continued to operate throughout the COVID-19 pandemic, and delivered strong production results in Q2, consistent with the original 2020 plan and below budget. Adjustments were made to the original 2020 mine plan by reducing waste and ore mined through the second quarter to ensure the health and safety of employees operating in the pit and to reduce variable costs. The process plant continued at full capacity, with additional safety measures in place, processing ore almost entirely from the South Lobe. Overall performance during the second quarter remains consistent with the strong operational results achieved over the past two years.

  Operational highlights from Q2 2020 were as follows:

    - Ore and waste mined of 0.7 million tonnes and 0.6 million tonnes, respectively
    - 0.71 million tonnes of ore processed resulting in 101,203 carats recovered, achieving a recovered grade of 14.3 carats per hundred tonnes

  - 201 Specials (+10.8 carats) recovered from direct milling during the second quarter, representing 6.4% weight percentage of total direct milling recovered carats, in line with mine plan expectations
  - 9 diamonds were recovered greater than 100 carats in weight, including 2 > 200 carats in weight

- Sales of $7.5 million were generated through the second quarter tender of stones smaller than 10.8 carats held on June 18th in Antwerp. Sales on Clara continued throughout Q2 with 5 sales completed, providing liquidity for the Company in this unexpected period of travel restrictions. Clara's customer base increased from 32 to 35 during the second quarter and now stands at 46.

- No diamonds in excess of +10.8 carats were sold in the second quarter. Instead, these diamonds, which represent about 70% of Lucara's revenue, will be sold under the recently announced 2020 supply agreement with HB. The purchase price paid for Lucara's +10.8 carat rough diamonds will be based on the estimated polished outcome, with a true up paid on actual achieved polished sales thereafter, less a fee and the cost of manufacturing. Starting in Q3 2020, this pricing mechanism is expected to deliver regular cash flow for this important segment of our production profile at superior prices.

- A deposit of $13.5 million was received by the Company as partial payment for +10.8 carat goods delivered to HB under the new sales agreement. This deposit has been recognized as deferred revenue as of June 30, 2020. As polished goods are sold by HB under the new sales agreement, the Company will recognize the revenue associated with the sale of those goods and their corresponding inventory cost.

- Total revenue of $7.5 million was recognized in Q2 2020 (Q2 2019: $42.5 million) or $109 per carat (Q2 2019: $417 per carat) from the sale of 68,979 carats (Q2 2019: 101,931 carats). Only stones in size classes below 10.8 carats were sold during the second quarter of 2020. The achieved price in Q2 2020 for the stones in size classes below 10.8 carats reflects the overall rough market price erosion.

- Lucara recognized revenue of $41.6 million for the six months ended June 30, 2020 ("H1 2020") from the sale of 155,158 carats or $268 per carat. This represents a significant decrease from revenue of $91.2 million recognized for the six months ended June 30, 2019 ("H1 2019") from the sale of 196,989 carats or $463 per carat. Most of the decrease in revenue results from Q2 production of the +10.8 carat diamonds being put into manufacturing to be sold through the new supply agreement with HB.

- The Company recorded a net loss of $13.9 million for Q2 2020 resulting in a $0.04 loss per share for the quarter. This compares to net income of $0.7 million for Q2 2019 and earnings per share of $Nil. A decrease in total revenue, predominantly from deferral of sales of +10.8 carat stones, had the most significant impact on the current quarter's results.

- Cash flow used in operations in Q2 2020 totalled $4.9 million compared to cash flow earned from operations of $6.5 million in Q2 2019, largely due to the decrease of $35.1 million in comparable revenue between the periods and an increased outflow for taxes payable relating to 2019 tax payments required in 2020.

- Operating cash cost(1) per tonne of ore processed for the six months ended June 30, 2020 was $27.14 per tonne (Q2 2019: $31.16 per tonne), which is below the initial full year forecast cash cost of $32-$36 per tonne processed and 13% lower than the comparative quarter last year. The operating cash cost per tonne processed in Q2 2020 was positively impacted by foreign exchange depreciation of the Botswana Pula of 7% against the U.S. dollar and the benefits of cost optimization efforts undertaken in the second half of 2019, offset by a 9% decrease in tonnes processed as compared to Q2 2019.

- Adjusted EBITDA(1) year to date was negative $1.8 million (H1 2019: $38.6 million). Adjusted EBITDA was affected by the decrease in total revenue mainly from the decision to withhold the +10.8 carat diamonds from the Q2 tender but also in part due to market conditions for the smaller goods sold, particularly in the second quarter tender held in June. Operating expenses per carat sold[(1)] totalled $189 per carat in the six months ended June 30, 2020, up from $171 per carat sold in the comparable period last year. Total carats sold were approximately 21% less by volume than the same period last year (H1 2020: 155,158 carats sold; H1 2019: 196,989 carats sold). Adjusted EBITDA and the average price per carat sold were significantly affected by the absence of large stone sales in the second quarter. Each carat holds the same cost to produce, however, the revenue and resulting margin is driven by the value of the large stones which were not sold in Q2 2020.

- As at June 30, 2020, the Company had cash and cash equivalents of $13.7 million, an increase of $2.5 million from December 31, 2019. The Company maintained draws totaling $19.0 million on the working capital facility from Q1 2020, however up to $31.0 million is available to be drawn for working capital, if required. The Company ended the second quarter with a strong cash position and available liquidity.

- The full impact of COVID-19 on Lucara's operations and production outlook for 2020 remains highly uncertain, and as a result, the Company is maintaining the suspension of its 2020 guidance until further notice.

(1) Non-IFRS measure (see page 10 for details)

## FINANCIAL HIGHLIGHTS

**Table 1:**

| *In millions of U.S. dollars except carats or otherwise noted* | **Three months ended June 30, 2020** | **2019** | **Six months ended June 30, 2020** | **2019** |
|---|---|---|---|---|
| Revenues | $ 7.5 | $ 42.5 | $ 41.6 | $ 91.2 |
| Net income (loss) for the period | (13.9) | 0.7 | (17.1) | 8.1 |
| Earnings (loss) per share (basic and diluted) | (0.04) | 0.00 | (0.04) | 0.02 |
| Operating cash flow per share* | (0.02) | 0.03 | 0.00 | 0.08 |
| Cash on hand | 13.7 | 7.1 | 13.7 | 7.1 |
| Amounts drawn on working capital facility | 19.0 | 5.0 | 19.0 | 5.0 |
| | | | | |
| Average price per carat sold ($/carat)* | 109 | 417 | 268 | 463 |
| Operating expenses per carat sold ($/carat)* | 174 | 174 | 189 | 171 |
| Operating margin per carat sold ($/carat)* | (65) | 243 | 76 | 292 |
| Carats sold | 68,979 | 101,931 | 155,158 | 196,989 |

(*) Operating cash flow per share, average price per carat sold, operating expenses per carat sold and operating margin per carat sold are Non-IFRS measures, see Table 2: Results of Operations for reconciliations and page 10 for "Non-IFRS measures" below.

The Company recognized revenue of $7.5 million or $109 per carat from the sale of 68,979 carats in the second quarter of 2020, inclusive of all diamonds sold on Clara. No +10.8 carat rough diamonds were sold during the second quarter of 2020. Amidst the uncertainty in the global markets from COVID-19, a decision was made to ensure value preservation of the Company's large stones which account for approximately 70% of our annual revenue but a smaller percentage of our overall production. The number of carats sold in Q2 2020 decreased by 32% as compared to Q2 2019, a combination of the +10.8 carat stones being placed into polishing and lower production in the comparable periods leading to fewer diamonds less than 10.8 carats in size made available for sale on Clara or through tender.

In July 2020, Lucara announced a definitive supply agreement with HB for the remainder of the year for all of the diamonds produced in excess of +10.8 carats from the Karowe Diamond mine. Under this supply agreement, Lucara's +10.8 carat production will be sold at prices based on the estimated polished outcome determined through state of the art scanning and planning technology, with a true up paid on actual achieved polished sales thereafter, less a fee and the cost of manufacturing. This unique pricing mechanism is expected to deliver regular cash flow for this important segment of our production profile at superior prices. As a result of the timing of sales, the Company expects to begin recognizing revenue from this sales agreement in the third quarter. A deposit of $13.5 million was received by the Company for a portion of +10.8 carat goods delivered under the new sales agreement. That deposit has been recognized as deferred revenue as at June 30, 2020.

Operating expenses decreased from $17.7 million in the three months ended June 30, 2019 to $12.0 million in the three months ended June 30, 2020 due to a lower number of carats sold (minus 32%) and reduced waste mining costs. Operating expenses per carat sold was comparable at $174 per carat in both periods. As each carat holds the same cost to produce, the impact of the lower average price per carat sold reduced the operating margin per carat sold from $243 for the three months ended June 30, 2019 to negative $65 per carat for the three months ended June 30, 2020. As the higher value +10.8 carat production deferred in the second quarter is recognized in revenue through the HB supply agreement, the margin should adjust accordingly in future periods.

Depletion and amortization decreased from $12.1 million for the three months ended June 30, 2019 to $8.0 million for the three months ended June 30, 2020 also due to the lower volume of carats sold.

Combined, the Company recognized a loss from mining operations of $13.3 million in the second quarter of 2020 compared to earnings of $8.5 million in the second quarter of 2019. The change in sales approach for the large stones had the most significant impact on the loss from mining operations, Adjusted Earnings Before Interest, Tax, Depletion and Amortization ("Adjusted EBITDA", a non-IFRS measure, see page 10 for details), net income and earnings per share when comparing results from each quarter.

Operations in the second quarter of 2020 were consistent with a strong, stable operating environment and were achieved according to the original 2020 plan. Certain adjustments were made in the pit to accommodate the health & safety of employees and to temporarily reduce variable mining costs. During Q2 2020, 0.7 million tonnes of ore and 0.6 million tonnes of waste was mined. The plant processed 0.71 million tonnes during the second quarter, consistent with the initial 2020 plan. The total tonnes processed in 2020 are expected to be slightly less than the record 2.8 million tonnes processed in 2019 due to several planned multi-day shut-downs to upgrade the XRT technology which is a key part of the recovery circuit at the Karowe Mine. Despite the challenges presented by the COVID-19 pandemic, the Karowe Mine continues to operate at full production levels, with social distancing and other critical health and safety measures designed to limit the spread of the virus being observed.

## RESULTS OF OPERATIONS – KAROWE MINE

**Table 2:**

| | UNIT | Q2-20 | Q1-20 | Q4-19 | Q3-19 | Q2-19 |
|---|---|---|---|---|---|---|
| **Sales** | | | | | | |
| Revenues generated from the sale of Karowe diamonds in the quarter | US$M | 7.3 | 33.8 | 56.0 | 45.3 | 42.5 |
| Carats recovered from Karowe sold for revenues recognized during the period | Carats | 68,861 | 86,010 | 98,547 | 116,200 | 101,931 |
| Average price per carat for proceeds received during the period | US$ | 107 | 393 | 568 | 390 | 417 |
| **Production** | | | | | | |
| Tonnes mined (ore) | Tonnes | 683,282 | 878,087 | 694,591 | 823,875 | 773,861 |
| Tonnes mined (waste) | Tonnes | 591,804 | 1,199,660 | 740,593 | 1,489,668 | 1,826,972 |
| Tonnes processed | Tonnes | 705,421 | 639,430 | 647,502 | 680,665 | 713,037 |
| Average grade processed | cpht (*) | 14.3 | 14.3 | 13.3[1] | 13.9[2] | 14.2[3] |
| Carats recovered | Carats | 101,203 | 91,536 | 86,422[1] | 104,990[2] | 109,312[3] |
| **Costs** | | | | | | |
| Operating costs per carat sold (see page 10 Non-IFRS measures) | US$ | 174 | 201 | 209 | 201 | 174 |
| Sustaining capital expenditures | US$M | 3.7 | 2.4 | 13.0 | 0.7 | 1.4 |
| Underground expansion project | US$M | 3.9 | 1.7 | - | - | - |

(*) carats per hundred tonnes

(1) Carats recovered during the period included 273 carats recovered from re-processing historic recovery tailings from previous milling and are excluded from the average grade processed.

(2) Carats recovered during the period included 10,646 carats recovered from re-processing historic recovery tailings from previous milling and are excluded from the average grade processed.

(3) Carats recovered during the period included 8,172 carats recovered from re-processing historic recovery tailings from previous milling and are excluded from the average grade processed.

## SECOND QUARTER OVERVIEW – OPERATIONS - KAROWE MINE

**Safety:** Karowe had no lost time injuries during the three months ended June 30, 2020 resulting in a twelve-month rolling Lost Time Injury Frequency Rate of 0.

**Production**: Ore and waste mined during the three months ended June 30, 2020 totaled 0.7 million tonnes and 0.6 million tonnes respectively.  Tonnage processed was 0.71 million tonnes, with a total of

101,203 carats recovered. During Q2 2020, ore processed was almost entirely from the South lobe and a total of 201 Specials were recovered including 9 diamonds greater than 100 carats in weight of which 2 diamonds were each > 200 carats in weight. Recovered Specials equated to 6.4% weight percentage of total recovered carats from ore processed during Q2 2020, consistent with expectations.

Overall performance during the second quarter remains consistent with the strong operational results achieved over the past two years. The process plant continued at full capacity during lockdowns experienced locally in Botswana in April and May 2020, with additional provisions in place to ensure the health and safety of employees. Adjustments were made to the level of operations in the pit to reduce the number of staff to allow for social distancing and in a deliberate decision to reduce operating expenses, and as a result, waste and ore mined were lower than originally anticipated for two months. These changes did not impact carat recoveries. Operations have continued according to the mine plan, with more ore delivered directly to the plant.

**Karowe's operating cash cost:** Karowe's year to date operating cash cost (see page 10 Non-IFRS measures) was $27.14 per tonne of ore processed (YTD 2020: $31.16 per tonne of ore processed) below the initial full year forecast of $32-$36 per tonne processed and approximately 13% lower than the same period in 2019. The current period result includes the impact of a 7% depreciation of the Botswana Pula compared to the US Dollar reporting currency, and realized cost savings following a cost optimization process in the second-half of 2019, offset by a 9% decrease in tonnes processed as compared to YTD 2019.

## KAROWE UNDERGROUND UPDATE

On November 4, 2019, the Company announced the results of a Feasibility Study for an underground mine at Karowe. A copy of the Company's news release and the related technical report prepared pursuant to the requirements of NI 43-101 – *Standards of Disclosure for Mineral Projects* were filed on Sedar (www.sedar.com) and are available on the Company's website at: www.lucaradiamond.com.

In November 2019, Lucara's Board of Directors approved a $53 million capital program for the Karowe underground expansion project, with the majority of the budget scheduled to be spent in the latter part of the year and funded through the cash flow from current operations.

Given the uncertainty in global markets resulting from COVID-19, the originally planned capital budget has been reduced until more certainty exists around Lucara's cash flow projections. The 2020 program has been re-scoped to focus on long lead time critical-path items, detailed engineering and design, and limited site activity focused on earth works and geotechnical studies using local contractors while a State of Emergency remains in effect in Botswana.

During H1 2020, $5.6 million was spent on project execution activities including detailed engineering and design work and early procurement initiatives.

The Company is continuing to explore debt financing options for the underground expansion for those amounts which are expected to exceed the Company's cash flow from operations during the construction period. The underground expansion program has an estimated capital cost of $514 million and a five year period of development. In light of the uncertainty resulting from the COVID-19 pandemic, the Company is also reviewing its original estimates and assumptions for the quantum and timing of cash flows expected from the current operations against the anticipated financing requirement for the underground expansion program. Financing options continue to be assessed.

## CLARA

Five sales occurred on Clara during the second quarter of 2020. As travel restrictions have significantly hampered many diamond traditional sales, Clara's customer base grew 30% during the first half of 2020, from 27 to 35 buyers. During July 2020, a further 11 buyers joined the platform, the most significant monthly growth to-date, increasing the total number of buyers on Clara to 46. As Clara becomes the online marketplace of choice for rough buyers, discussions are underway with several sellers to begin trials for the sale of third party supply on Clara, a key objective for 2020. We anticipate starting trials of third party diamonds during the third quarter.

## LIQUIDITY AND CAPITAL RESOURCES

As at June 30, 2020, the Company had cash and cash equivalents of $13.7 million, a $2.5 million increase in cash from $11.2 million at December 31, 2019 (June 30, 2019: $7.1 million). Working capital as at June 30, 2020 totalled $46.9 million as compared to working capital of $60.9 million as at December 31, 2019 (June 30, 2019: $56.9 million). The Company's working capital position remains strong and the period to period decrease is mostly due to the change in how the +10.8 carat stones will be sold for the remainder of 2020. The Company has no long term debt and $31.0 million of available liquidity from a $50 million revolving credit facility.

Cash flow used in operations was $2.5 million during the first half of 2020, a change from the $17.2 million provided by operating cash flow in the first half of 2019. Lower revenues, a weaker diamond price environment observed in the first half of 2020 and an outflow for tax payments were the main drivers for this difference. A deposit of $13.5 million was received from HB during Q2 2020 as a partial payment under the new supply agreement. Capital spending during the first half remains focused on the underground expansion project (H1 2020: $5.6 million; H1 2019: $8.4 million) and sustaining capital expenditures of $6.6 million (H1 2019: $3.8 million) including improvements to the XRT technology used in the recovery circuit.

Financing activities during the first half of 2020 included draw downs from the working capital facility of $19.0 million (2019: repayment of $5.0 million) to manage fluctuations in working capital. In addition, during H1 2019, the Company paid dividends of $14.9 million for which there is no comparable allocation in 2020. The Company suspended the quarterly dividend payment in November 2019 to allow excess capital to be directed to the underground expansion program.

The Company had drawn $19.0 million on its working capital facility as at June 30, 2020 (June 30, 2019: $5.0 million; December 31, 2019 - $nil outstanding). Amounts available under the credit facility were $31.0 million as of June 30, 2020 ($50.0 million as of December 31, 2019). The facility contains financial and non-financial covenants customary for a facility of this size and nature. In June 2020, the Bank of Nova Scotia agreed to amend the minimum level of tangible net worth required to be maintained by the Company to $200 million. As at June 30, 2020, the Company was in compliance with all financial and non-financial covenants. Outstanding amounts under the facility bear interest at LIBOR or an alternative base rate plus an applicable margin based on the Company's adjusted leverage ratio

Long-term liabilities have remained consistent in source currency and changes are mainly due to the movement in the foreign exchange conversion from the Botswana Pula to the Company's reporting currency of the U.S. dollar. Long-term liabilities consist of restoration provisions of $22.4 million (2019: $23.6 million), deferred income taxes of $52.4 million (2019: $63.0 million), and other non-current liabilities of $0.9 million (2019: $0.8 million) which consist of leases reclassified under *IFRS 16: Leases* as of January 1, 2019.

Total shareholders' equity decreased from $236.9 million as at December 31, 2019 to $198.8 million as at June 30, 2020, mainly due to the cumulative translation adjustment of negative $21.7 million in accumulated other comprehensive loss resulting from the translation of functional currency to the Company's reporting currency of the U.S. dollar. Other minor changes to share capital and contributed surplus were related to share units vesting and the recording of share-based compensation during the period.

## 2020 OUTLOOK

This section of the MD&A provides management's outlook for 2020. These are "forward-looking statements" and subject to the cautionary note regarding the risks associated with forward-looking statements.

On March 31, 2020, the Company announced the suspension of its 2020 guidance until further notice. The full impact of the COVID-19 pandemic on Lucara's operations and production outlook for 2020 remains highly uncertain and may remain that way for several months. Further guidance will be released as the impact of COVID-19 becomes known.

The global diamond industry is experiencing the widespread impacts of COVID-19 throughout the value chain, manifested as fewer sales, weaker pricing, delays in the movement of goods and people and, production curtailments at several mines. As outbreaks from COVID-19 increase and subside around the world, there are differing impacts to the diamond industry. The polished industry is heavily dependent on retail store openings in the United States and China. The manufacturing industry is predominately situated in India, with high concentrations of buyers in Belgium, Israel, United Arab Emirates and Botswana. Rough supply is being affected by production curtailments and the varying level of government restrictions in the countries in which diamond miners operate. While full production levels are currently being sustained at the Karowe Diamond Mine, Lucara cannot predict if future changes or regulations implemented by the Government of Botswana will affect its operations in the near term.

Lucara held a second quarter tender in Antwerp in the second week of June, rescheduled from mid-May. Lucara is planning a third tender to be held in early September with dates to be confirmed based on market conditions. Preparation of goods for the Q3 2020 tender are in progress. Sales continue on the Clara platform, with logistical disruptions previously experienced in Q2 having been alleviated as travel restrictions have relaxed in Europe and cargo flights are more frequent out of Southern Africa.

Lucara's capital spending program for 2020, which was focused on the underground expansion has been re-scoped to focus on critical-path items through the remainder of the year. Most of the previously approved capital spend of $53 million for the Karowe underground expansion project was scheduled to be invested in the latter part of the year and funded through cash flow from operations. Given the uncertainty in global markets resulting from COVID-19, these capital expenditures will be reduced until more certainty exists around Lucara's cash flow projections. The sales arrangement with HB for the +10.8 carat diamonds as polished is expected to provide a more stable monthly cash flow in the latter part of the year.

## SELECT FINANCIAL INFORMATION

| *Table 3:* <br> *In millions of U.S. dollars unless otherwise noted* | **Three months ended June 30,** <br> **2020** | <br> 2019 | **Six months ended June 30,** <br> **2020** | <br> 2019 |
|---|---|---|---|---|
| Revenues | $ 7.5 | $ 42.5 | $ 41.6 | $ 91.2 |
| Operating expenses | (12.0) | (17.7) | (29.3) | (33.7) |
| **Operating (loss) earnings [(1)]** | **(4.5)** | **24.8** | **12.3** | **57.5** |
| Royalty expenses | (0.7) | (4.3) | (4.2) | (9.1) |
| Exploration expenditures | (0.5) | (1.0) | (1.1) | (2.0) |
| Administration | (3.7) | (4.0) | (7.7) | (6.7) |
| Sales and marketing | (0.6) | (0.5) | (1.1) | (1.1) |
| **Adjusted EBITDA [(2)]** | **(10.0)** | **15.0** | **(1.8)** | **38.6** |
| Depletion and amortization | (8.0) | (12.1) | (18.5) | (23.7) |
| Finance expenses | (0.8) | (0.8) | (1.6) | (1.6) |
| Foreign exchange loss (gain) | 0.3 | (0.4) | 0.6 | (1.3) |
| Current income tax recovery (expense) | 1.7 | (4.2) | (0.3) | (8.8) |
| Deferred income tax recovery | 2.9 | 3.1 | 4.5 | 4.9 |
| **Net income (loss) for the period** | **(13.9)** | **0.7** | **(17.1)** | **8.1** |
| | | | | |
| **Change in cash during the period** | **(13.7)** | (10.8) | 2.5 | (17.3) |
| **Cash on hand** | **13.7** | 7.1 | 13.7 | 7.1 |
| **Earnings (loss) per share (basic and diluted)** | **(0.04)** | 0.00 | (0.04) | 0.02 |
| | | | | |
| **Per carat sold:** | | | | |
| **Sales price** | **$ 109** | $ 417 | **$ 268** | $ 463 |
| **Operating expenses** | **174** | 174 | **189** | 171 |
| | | | | |
| **Average grade (carats per hundred tonnes) [(3)]** | **14.3** | 14.2 | **14.3** | 15.1 |

(1) Operating (loss) earnings is a non-IFRS measure (see page 10) defined as revenues less operating expenses.
(2) Adjusted EBITDA is a non-IFRS measure (see page 10) defined as earnings before interest, taxation, depreciation and amortization.
(3) Average grade processed is from direct milling carats and excludes carats recovered from re-processing historic recovery tailings from previous milling.

### *Revenues*

During Q2 2020, Lucara sold 68,979 carats below 10.8 carats in size at an average price of $109/carat, resulting in total revenue of $7.5 million. No diamonds above 10.8 carats were made available for sale in the second quarter. This compares to revenue of $42.5 million or $417/carat sold in the second quarter of 2019.

During the second quarter of 2020, 68,979 carats were sold representing a 32% decrease from the 101,931 carats sold in the second quarter of 2019. An inventory build did occur in the second quarter related to +10.8 carat stones placed into manufacturing but not yet sold. As at June 30, 2020, the $71.4 million inventory balance consists of rough diamonds carried at a value of $31.8 million (December 31, 2019: $24.5 million), ore stockpiles carried at a value of $27.6 million (December 31, 2019: $28.4 million) and parts and supplies of $12.1 million (December 31, 2019: $12.2 million). The Company regularly reviews the carrying values of its assets for impairment; no impairment losses were recorded in either H1 2020 or H1 2019.

### *Operating Earnings and Expenses*

During Q2 2020, the Company recorded an operating loss of $4.5 million or $65/carat (Q2 2019: earnings of $24.8 million or $243/carat) after operating expenses during the quarter of $12.0 million or $174/carat (Q2 2019: $17.7 million or $174/carat).

The movement in operating earnings and margin results from a change in how revenue is recognized for the large stones in Karowe's production profile, beginning in Q2 2020. As the cost to produce each carat is consistent, but only the smaller size classes of Karowe's production were sold in the second quarter, the impact to operating earnings per carat is pronounced. A reversal of this trend as revenue is recognized from the sale of the larger stones through the supply agreement is expected starting in Q3 2020.

Operations were consistent through the second quarter. Lucara achieved an average grade processed of 14.3 carats per hundred tonnes ("cpht") during Q2 2020, which was directly comparable to an average grade of 14.2 cpht from direct milling carats in Q2 2019. Recoveries in Q2 2020 of 101,203 carats were directly comparable to the 101,140 carats recovered in Q2 2019 (excluding 8,172 carats recovered from re-processing tailings previously milled).

Operating loss/earnings is a non-IFRS measure and is reconciled in Table 3 above.

### *Depletion and Amortization*

The Company incurred a depletion and amortization charge of $8.0 million (Q2 2019: $12.1 million) for Q2 2020 resulting from a 32% decrease in carats sold between the periods.

### *Net Income and Adjusted Earnings Before Interest, Tax, Depletion and Amortization (Adjusted EBITDA)*

The Company recorded a net loss for Q2 2020 of $13.9 million (Q2 2019: net income of $0.7 million). Adjusted EBITDA for the three months ended June 30, 2020 was a loss of $10.0 million as compared to income of $15.0 million in Q2 2019.

Decreases in Net Income and Adjusted EBITDA are consistent with the decrease in revenue between comparable quarters attributable to the change in sales approach for the large stones greater than +10.8 carats.

Adjusted EBITDA is a non-IFRS measure and is reconciled in Table 3 above.

### *Operating Cost Per Tonne of Ore Processed*

Operating cost per tonne of ore processed was $27.14 (2019: $31.16). Factors influencing the operating cost per tonne of ore processed include a weakening of the Botswana Pula in 2020 offset by a decrease in tonnes processed of 9%. Smaller net increases in both rough diamond inventory (+ $5.1 million) and the ore stockpile inventory (+ $2.1 million) also contributed to a lower operating cost per tonne of ore processed as compared to H1 2019.

Operating cost per tonne processed is a non-IFRS measure and is reconciled in Table 7 to the most directly comparable measure calculated in accordance with IFRS, which is operating expenses.

## SUMMARY OF QUARTERLY RESULTS

(All amounts expressed in thousands of U.S. dollars, except per share data). The Company's interim financial statements are reported under IFRS applicable to interim financial reporting.

**Table 5**: The following table provides highlights, extracted from the Company's financial statements, of quarterly results for the past eight quarters:

| Three months ended | Jun-20 | Mar-20 | Dec-19 | Sept-19 | Jun-19 | Mar-19 | Dec-18 | Sept-18 |
|---|---|---|---|---|---|---|---|---|
| A. Revenues | 7,462 | 34,117 | 55,993 | 45,317 | 42,541 | 48,690 | 40,609 | 45,669 |
| B. Administration expenses | (3,653) | (4,071) | (4,993) | (3,921) | (3,960) | (2,777) | (4,369) | (2,849) |
| C. Net income (loss) | (13,915) | (3,161) | 8,635 | (4,012) | 675 | 7,416 | (6,225) | 5,136 |
| D. Earnings (loss) per share (basic and diluted) | (0.04) | (0.01) | 0.02 | (0.01) | 0.00 | 0.02 | (0.02) | 0.01 |

The Company's quarterly results, including net income and earnings (loss) per share are most directly affected by the sale of unique and high value diamonds. In July 2020, the Company announced a supply agreement with the HB Group for all stones sized above +10.8 carats. Under the terms of the supply agreement, the purchase price paid shall be based on the estimated polished outcome, with a true up paid on actual achieved polished sales thereafter, less a fee and the cost of manufacturing. This change is expected to result in a more stable cash flow with access to price improvements along the value chain when compared to previous quarters where all diamonds recovered were typically sold in the quarterly tender. The Company's quarterly revenue is also affected by the number and quality of stones available for sale in any given quarter.

Revenue recognized in the quarter ended June 30, 2020 represents the sales of its smaller stones (-10.8 carats) through two sales channels: Clara and a tender held in June. The decrease in revenue is reflective of the change in the Company's sales approach for its large stones, which represent approximately 70% by value and 6-8% by weight. **No large stones were sold during the second quarter of 2020**.

Revenue recognized in the quarter ended March 31, 2020 was significantly less than revenue recognized in Q1 2019, resulting from a combination of lower overall prices and the quality of goods available for sale (in the quarter ended March 31, 2019 several higher value stones were sold). Early impacts of COVID-19 were observed in the lower pricing achieved in the Q1 2020 tender. Similarly, the availability of large, high-quality stones in the Q4 2019 tender resulted in a higher revenue achieved when compared to the quarter ended March 31, 2020.

The quarter ended December 31, 2019 was representative of a stronger pricing environment combined with a better blend of stones available for sale as compared to the quarter ended December 31, 2018. Q4 2018 saw a particularly weak tender following significant inventory builds and liquidity issues in the mid-stream of the industry. The end of 2019 saw a return to a more stable pricing environment for most of the Company's goods available for sale.

The quarter ended September 30, 2019 is directly comparable to the prior year quarter in which one blended tender was held. The quarter to quarter change in revenue was $0.4 million, decreasing slightly from $45.7 million in Q3 2018 to $45.3 million in Q3 2019.

The net income achieved in each quarter is most impacted by the revenue earned during that quarter.

## NON-IFRS FINANCIAL MEASURES

This MD&A refers to certain financial measures, such as adjusted EBITDA, operating earnings, operating cash flow per share, operating cost per carat sold, and operating cost per tonne of ore processed, which are not measures recognized under IFRS and do not have a standardized meaning prescribed by IFRS. These measures may differ from those made by other corporations and accordingly may not be comparable to such measures as reported by other corporations. These measures have been derived from the Company's financial statements, and applied on a consistent basis, because the Company believes they are of assistance in the understanding of the results of operations and financial position.

Adjusted EBITDA (see "Select Financial Information") is the term the Company uses as an approximate measure of the Company's pre-tax operating cash flow and is generally used to measure performance and evaluate trends of individual assets. Adjusted EBITDA comprises earnings before deducting interest and other financial charges, income taxes, depreciation and amortization.

Operating earnings (see "Select Financial Information") is the term the Company uses as an approximate measure of the earnings from the operations under an accrual basis of accounting defined as revenues less operating expenses.

Operating cash flow per share is the term the Company uses to assess its ability to generate cash flow from operations, while also taking into consideration changes in the number of outstanding common shares of the Company. Operating cash flow per share is calculated by taking cash flows from operating activities, less changes in non-cash working capital items, divided by the basic weighted average number of common shares outstanding. The most directly comparable measure calculated in accordance with IFRS is cash flows from operating activities. A table reconciling the two measures is presented below.

**Table 6: Operating cash flow per share reconciliation:**

| *In millions of U.S. dollars with the exception of weighted average common shares outstanding and operating cash flow per share* | **Three months ended June 30** | | **Six months ended June 30** | |
|---|---|---|---|---|
| | **2020** | 2019 | **2020** | 2019 |
| Cash flows from operating activities | $ (4,898) | $ 6,536 | $ (2,541) | $ 17,173 |
| Add: Changes in non-cash working capital | (2,687) | 5,544 | 1,860 | 13,287 |
| Total cash flow from operating activities before changes in non-cash working capital | (7,585) | 12,080 | (681) | 30,460 |
| Weighted average common shares outstanding | 396,896,733 | 396,853,867 | 396,881,900 | 396,722,617 |
| **Operating cash flow per share(1)** | **$(0.02)** | $0.03 | **$0.00** | $0.08 |

(1) Operating cash flow per share for the period is a non-IFRS measure defined as cash flows from operating activities, less changes in non-cash working capital items, divided by the basic weighted average number of common shares outstanding for the period.

Operating costs per carat sold (see "Karowe Mine, Botswana") is the term the Company uses to describe the mining, processing and site administration costs to produce a single diamond carat. This is calculated as operating costs per carat of diamonds sold.

Operating cost per tonne of ore processed (see "Select Financial Information") is the term the Company uses to describe operating expenses per tonne processed on a cash basis. This is calculated as operating cost divided by tonnes of ore processed for the period. This ratio provides the user with the total cash costs incurred by the mine during the period per tonne of ore processed, including waste capitalisation costs, mobilization costs and working capital movements. The most directly comparable measure calculated in accordance with IFRS is operating expenses. A table reconciling the two measures is presented below.

**Table 7: Operating cost per tonne of ore processed reconciliation:**

| *In millions of U.S. dollars with the exception of tonnes processed and operating cost per tonne processed* | **Six months ended June 30,** | | | |
|---|---|---|---|---|
| | | **2020** | | 2019 |
| Operating expenses | $ | 29.3 | $ | 33.7 |
| Net change rough diamond inventory, excluding depletion and amortization (1) | | 5.1 | | 6.0 |
| Net change ore stockpile inventory, excluding depletion and amortization (2) | | 2.1 | | 6.3 |
| Total operating costs for ore processed | | 36.5 | | 46.0 |
| Tonnes processed | | 1,344,851 | | 1,476,350 |
| **Operating cost per tonne of ore processed** (3) | **$** | **27.14** | $ | 31.16 |

(1) Net change in rough diamond inventory, excluding depletion and amortization.

(2) Net change in ore stockpile inventory, excluding depletion and amortization.

(3) Operating cost per tonne processed for the period is a non-IFRS measure defined as the sum of operating expenses, capitalized production stripping costs, and the net changes in rough diamond inventories and ore stockpiles divided by the tonnes of ore processed for the period.

## RELATED PARTY TRANSACTIONS

A description of key management compensation can be found in Note 9 of the condensed interim consolidated financial statements for the three and six months ended June 30, 2020.

In relation to the acquisition of Clara in February 2018, certain related parties may receive additional shares of Lucara if Clara, now a wholly-owned subsidiary of Lucara, achieves certain levels of revenue generated by sales on the platform (the "Performance Milestones"). The Performance Milestones are detailed in Note 9 of the audited consolidated financial statements for the year ended December 31, 2019. As of June 30, 2020, none of the revenue milestones had been achieved.

A profit sharing mechanism also exists which is detailed in Note 9 of the audited consolidated financial statements for the year ended December 31, 2019. To-date, no amounts have been paid under this profit sharing mechanism.

## FINANCIAL INSTRUMENTS AND CAPITAL MANAGEMENT

In the normal course of business, the Company is inherently exposed to currency and commodity price risk. The Company's financial instruments are exposed to certain financial risks, including currency, credit, liquidity and price risks.

*Currency risk*

The Company is exposed to the financial risk related to fluctuating foreign exchange rates. All sales revenues are denominated in U.S. dollars, while most operating costs are denominated in the Botswana Pula. At June 30, 2020, the Company is exposed to currency risk relating to U.S. dollar cash held within its subsidiaries with Canadian or Pula functional currency. Based on this exposure, a 10% change in the U.S. dollar exchange rate would give rise to an increase/decrease of approximately $1.1 million in net income for the year.

*Credit risk*

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. A majority of the Company's cash and cash equivalents are held through a large Canadian financial institution with a high investment grade rating. Considering the nature of the Company's ultimate customers and the relevant terms and conditions entered into with such customers, the Company believes that credit risk is limited as goods are not released until full payment is received.

Under the new supply agreement with HB announced in July, a larger proportion of the Company's goods will be sold through HB to polished buyers. The credit risk associated with these sales will concentrate with one individual customer and payment terms are longer (60 days) than the Company's traditional tender sales (5 days).

The carrying amount of financial assets recorded in the financial statements, net of any allowance for losses, represents the Company's maximum exposure to credit risk.

*Price risk*

The Company derives its income from the sale of rough diamonds mined in Botswana, a majority of which are sold through a quarterly tender process from Botswana. The price and marketability of these diamonds can be significantly impacted by international economic trends, global or regional consumption, demand and supply patterns and the availability of capital for diamond manufacturers, all factors that are not within the Company's control. Under the supply agreement, the ultimate achieved sales prices of stones larger than 10.8 carats in size will be based on a polished diamond pricing mechanism. This pricing mechanism will result in the Company's revenue being exposed to a greater extent to the price movements in the polished diamond market than it is currently through its traditional tender process. The COVID-19 pandemic has negatively impacted global demand for luxury commodities, which includes jewelry containing diamonds. Restrictions on international travel have also disrupted the diamond supply chain. To the extent that the supply of rough or polished diamonds exceeds demand, this is likely to result in price deterioration and negatively impact the Company's revenue, thereby increasing the risk that not only will operations not be profitable, the Company may not have sufficient liquidity to meet its financial obligations as they come due.

*Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. To manage liquidity risk, regular cash flow forecasting is performed in the operating entities of the Company and aggregated in the head office to understand what level of capital is required. Rolling forecasts of the Company's liquidity requirements are prepared and monitored to assess whether there is sufficient cash available to meet the Company's short and longer-term operational needs. Such forecasting takes into consideration the Company's ability to generate cash from the sale of diamonds and additional liquidity which can be accessed through the revolving term credit facility.

The Company's $50 million revolving term credit facility with the Bank of Nova Scotia was extended for one year to May 5, 2021 following the quarter-end. Funds drawn under the revolving credit facility are due in full at maturity. The facility contains financial and non-financial covenants customary for a facility of this size and nature. Outstanding amounts under the facility bear interest at LIBOR or an alternative base rate plus an applicable margin based on the Company's leverage ratio. The Company has provided first-ranking security on the facility by way of a charge over the Company's Karowe assets and a guarantee by the Company's subsidiaries, which hold the Karowe assets.

As at June 30, 2020, $19.0 million was drawn on the facility for working capital purposes (March 31, 2020 - $19.0 million; December 31, 2019 - $nil) and $31.0 million was available to be drawn.

**OUTSTANDING SHARE DATA**

As at the date of this MD&A, the Company had 396,896,733 common shares outstanding, 2,946,527 share units, 294,923 deferred share units, and 4,462,000 stock options outstanding under its share-based incentive plans.

**RISKS AND UNCERTAINTIES**

The operations of the Company are speculative due to the high-risk nature of its business which includes the acquisition, financing, exploration, development and operation of diamond properties, the potential construction of an underground mine at Karowe and the continued commercialization of Clara. The material risk factors and uncertainties, which should be taken into account in assessing the Company's activities, are described under the heading "Risks and Uncertainties" in the Company's most recent Annual Information Form available at http://www.sedar.com (the "AIF"). Any one or more of these risks and uncertainties could have a material adverse effect on the Company.

**COVID-19 Global pandemic risk**

On March 11, 2020, the World Health Organization declared the novel coronavirus ("COVID-19") a global pandemic. With the majority of governments across the jurisdictions in which Lucara and many of its customers operate declaring a state of emergency in response to the COVID-19 pandemic, Lucara's operations could be impacted in a number of ways including, but not limited to: a suspension of operations at the Karowe Mine, by disruption to the progress of the Karowe Mine underground expansion project and by an inability to ship or sell rough (or polished) diamonds during this period.

These possible impacts could result from government directives, the need to modify work practices to meet appropriate health and safety standards, a build up of supply or a lack of demand for rough (or polished) diamonds, a lack of available liquidity to meet ongoing operational expenses and, due to or by other COVID-19 related impacts on the availability of labour or to the supply chain.

As a relatively novel risk, the duration and full financial effect of the COVID-19 pandemic is unknown at this time, as is the efficacy of government and central bank interventions in the jurisdictions in which Lucara and its clients operate, the Company's business continuity plan and other mitigating measures. While the impact of COVID-19 is expected to be temporary, the current circumstances are dynamic and the impacts of COVID-19 on our business, including the duration and impact that it may have on our ability to ship and sell diamonds, on demand for rough and polished diamonds, on achievable diamond prices, on our suppliers, on our employees and on global financial markets, cannot be reasonably estimated at this time. Accordingly estimates of the extent to which the COVID-19 pandemic may materially and adversely affect the Company's operations, financial results and condition in future periods are also subject to significant uncertainty.

In preparing our condensed interim consolidated financial statements, we make judgments in applying our accounting policies. The areas of policy judgement are consistent with those reported in our 2019 annual consolidated financial statements. In addition, we make assumptions about the future in deriving estimates used in preparing our condensed interim consolidated financial statements. As disclosed in our 2019 annual consolidated financial statements, the most significant sources of estimation uncertainty include estimated recoverable reserves and resources, valuation of mineral properties, the provision for deferred taxes and the valuation of decommissioning and site restoration provisions.

Management is required to exercise judgment to ensure that disclosures relating to liquidity and the Company's ability to continue as a going concern are appropriate. To this end, the Company manages liquidity risk by maintaining an adequate level of cash and cash equivalents to meet its short-term ongoing obligations and reviews its actual expenditures and forecast cash flows on a regular basis. Changes in demand for rough diamonds and diamond prices, production levels and related costs, foreign exchange rates and other factors all impact the Company's liquidity position.

Therefore, uncertainty about judgments, estimates and assumptions made by management during the preparation of the Company's condensed interim consolidated financial statements related to potential impacts of the COVID-19 outbreak on revenue, expenses, assets, liabilities, and note disclosures could result in a material adjustment to the carrying value of the asset or liability affected.

## OFF-BALANCE SHEET ARRANGEMENTS

Previously the Company's operating lease arrangements for offices in Botswana were considered to be off-balance sheet arrangements. With the adoption of *IFRS 16 – Leases*, as of January 1, 2019, these leases are no longer off-balance sheet arrangements. With the exception of short-term leases with a term of 12 months or less, the Company is not party to any off-balance sheet arrangements.

## CHANGES IN ACCOUNTING POLICIES

There have been no changes to accounting policies during the three and six months ended June 30, 2020. Note 3 to the audited consolidated financial statements for the year ended December 31, 2019 includes a summary of the significant accounting policies adopted by the Company.

## MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation of this document along with the unaudited condensed interim consolidated financial statements. Management is responsible for the integrity and objectivity of this document, ensuring the fair presentation of its financial results. The Audit Committee is responsible for reviewing the contents of this document along with the condensed interim consolidated financial statements to ensure the reliability and timeliness of the Company's disclosure while providing another level of review for accuracy and oversight. There have been no changes in the Company's disclosure controls and procedures during the three months ended June 30, 2020.

## INTERNAL FINANCIAL REPORTING AND DISCLOSURE CONTROLS

*Disclosure controls and procedures*

Disclosure controls and procedures are designed to provide reasonable assurance that all material information related to the Company is identified and communicated on a timely basis. Management of the Company, under the supervision of the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), is responsible for the design and operation of disclosure controls and procedures.

*Internal controls over financial reporting*

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS. Management is also responsible for the design of the Company's internal control over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. However, due to inherent limitations, internal controls over financial reporting may not prevent or detect all misstatements and fraud.

Management assesses the effectiveness of the Company's internal control over financial reporting using the Internal Control – Integrated Framework ("2013 Framework") issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

There have been no changes in the Company's internal control over financial reporting during the three months ended June 30, 2020 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

## CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

Certain of the statements made and contained herein in the MD&A and elsewhere constitute forward-looking statements as defined in applicable securities laws. Generally, these forward-looking statements can be identified by the use of forward-looking terminology such as "expects", "anticipates", "believes", "intends", "estimates", "potential", "possible" and similar expressions, or statements that events, conditions or results "will", "may", "could" or "should" occur or be achieved.

In particular, this MD&A may contain forward looking information pertaining to the following: the impact of COVID-19 pandemic on the Company's operations and cash flows and its plans with respect to the Karowe underground expansion project; the estimates of the Company's mineral reserves and resources; estimates of the Company's production and sales volumes for the Karowe Diamond Mine; estimated costs for capital expenditures related to the Karowe Diamond Mine; production costs; exploration and development expenditures and reclamation costs; expectation of diamond prices and the potential for the supply agreement with HB to achieve both higher prices from the sale of polished diamonds and to provide more regular cash flow than in previous periods; changes to foreign currency exchange rates; assumptions and expectations related to the possible development of an underground mining operation at Karowe including associated capital costs, financing strategies and timing; expectations in respect of the development and functionality of the technology related to the Clara platform, the intended benefits and performance of the Clara platform, including ability to complete sales without viewing diamonds, the growth of the Clara platform, the timing and frequency of sales on the Clara Platform, and the quantum and timing of participation of third parties on the Clara platform; expectations regarding the need to raise capital and its availability; possible impacts of disputes or litigation; and other risks and uncertainties described under the heading "Risks and Uncertainties" in the Company's most recent Annual Information Form available at http://www.sedar.com (the "AIF").

Forward-looking statements are based on the opinions, assumptions and estimates of management as of the date such statements are made, and they are subject to a number of known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievement expressed or implied by such forward-looking statements. Such assumptions include: the Company's ability to obtain necessary financing; the Company's expectations regarding the economy generally, results of operations and the extent of future growth and performance; and assumptions that the Company's activities will not be adversely disrupted or impeded by development, operating or regulatory risk. The Company believes that expectations reflected in this forward-looking information are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking information included in this MD&A should not be unduly relied upon.

There can be no assurance that such statements will prove to be accurate, as the Company's results and future events could differ materially from those anticipated in this forward-looking information as a result of those factors discussed in or referred to under the heading "COVID -19 Global Pandemic" in this MD&A and under the heading "Risks and Uncertainties" in the Company's AIF, as well as changes in general business and economic conditions, changes in interest and foreign currency rates, the supply and demand for, deliveries of and the level and volatility of prices of rough diamonds, costs and availability of power and diesel, acts of foreign governments and the outcome of legal proceedings, inaccurate geological and recoverability assumptions (including with respect to the size, grade and recoverability of mineral reserves and resources) and unanticipated operational difficulties (including failure of plant, equipment or processes to operate in accordance with specifications or expectations, cost escalations, unavailability of materials and equipment, government action or delays in the receipt of government approvals, industrial disturbances or other job actions, adverse weather conditions, and unanticipated events relating to health safety and environmental matters).

Accordingly, readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date the statements were made, and the Company does not assume any obligations to update or revise them to reflect new events or circumstances, except as required

# LUCARA DIAMOND CORP.

**CONDENSED INTERIM CONSOLIDATED BALANCE SHEETS**
**(Unaudited - in thousands of U.S. Dollars)**

| | | June 30, 2020 | | December 31, 2019 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Current assets | | | | |
| Cash and cash equivalents | $ | 13,691 | $ | 11,197 |
| VAT receivables and other | | 8,373 | | 6,248 |
| Tax prepayment | | 102 | | - |
| Inventories (Note 3) | | 71,442 | | 65,052 |
| | | 93,608 | | 82,497 |
| Investments | | 295 | | 241 |
| Plant and equipment (Note 4) | | 108,763 | | 130,108 |
| Mineral properties (Note 5) | | 92,840 | | 105,243 |
| Intangible assets (Note 6) | | 21,147 | | 22,774 |
| Other non-current assets | | 4,493 | | 5,168 |
| **TOTAL ASSETS** | $ | 321,146 | $ | 346,031 |
| **LIABILITIES** | | | | |
| Current liabilities | | | | |
| Trade payables and accrued liabilities | $ | 13,149 | $ | 15,880 |
| Credit facility (Note 11) | | 19,030 | | - |
| Deferred revenue (Note 3) | | 13,500 | | - |
| Taxes payable | | - | | 4,397 |
| Lease liabilities | | 1,034 | | 1,347 |
| | | 46,713 | | 21,624 |
| Restoration provisions | | 22,375 | | 23,629 |
| Deferred income taxes | | 52,442 | | 63,015 |
| Other non-current liabilities | | 869 | | 828 |
| **TOTAL LIABILITIES** | | 122,399 | | 109,096 |
| **EQUITY** | | | | |
| Share capital (unlimited common shares, no par value) | | 314,924 | | 314,820 |
| Contributed surplus | | 8,088 | | 7,679 |
| Deficit | | (48,570) | | (31,494) |
| Accumulated other comprehensive loss | | (75,695) | | (54,070) |
| **TOTAL EQUITY** | | 198,747 | | 236,935 |
| **TOTAL LIABILITIES AND EQUITY** | $ | 321,146 | $ | 346,031 |

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Approved on Behalf of the Board of Directors:

"Marie Inkster"
Director

"Catherine McLeod-Seltzer"
Director

## LUCARA DIAMOND CORP.
**CONDENSED INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS**
**(Unaudited - in thousands of U.S. Dollars, except for share and per share amounts)**

| | Three months ended June 30, 2020 | Three months ended June 30, 2019 | Six months ended June 30, 2020 | Six months ended June 30, 2019 |
|---|---|---|---|---|
| **Revenues** | $ 7,462 | $ 42,541 | $ 41,579 | $ 91,231 |
| **Cost of goods sold** | | | | |
| Operating expenses | 12,020 | 17,657 | 29,300 | 33,737 |
| Royalty expenses (Note 5) | 734 | 4,254 | 4,230 | 9,123 |
| Depletion and amortization | 7,972 | 12,125 | 18,464 | 23,710 |
| | 20,726 | 34,036 | 51,994 | 66,570 |
| **Income (loss) from mining operations** | (13,264) | 8,505 | (10,415) | 24,661 |
| **Other expenses** | | | | |
| Administration (Note 8) | 3,653 | 3,960 | 7,724 | 6,737 |
| Exploration expenditures | 493 | 953 | 1,085 | 2,002 |
| Finance expenses | 799 | 838 | 1,639 | 1,640 |
| Foreign exchange (gain) loss | (272) | 439 | (637) | 1,264 |
| Sales and marketing | 610 | 548 | 1,100 | 1,076 |
| | 5,283 | 6,738 | 10,911 | 12,719 |
| **Net income (loss) before tax** | (18,547) | 1,767 | (21,326) | 11,942 |
| **Income tax expense (recovery)** | | | | |
| Current income tax expense | (1,728) | 4,220 | 251 | 8,750 |
| Deferred income tax recovery | (2,904) | (3,128) | (4,501) | (4,899) |
| | (4,632) | 1,092 | (4,250) | 3,851 |
| **Net income (loss) for the period** | $ (13,915) | $ 675 | $ (17,076) | $ 8,091 |
| **Earnings (loss) per common share** | | | | |
| Basic | $ (0.04) | $ 0.00 | $ (0.04) | $ 0.02 |
| Diluted | $ (0.04) | $ 0.00 | $ (0.04) | $ 0.02 |
| Weighted average common shares outstanding | | | | |
| Basic | 396,896,733 | 396,853,867 | 396,881,900 | 396,722,617 |
| Diluted | 396,896,733 | 397,904,267 | 396,881,900 | 397,893,009 |

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

## CONDENSED INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

**(Unaudited - in thousands of U.S. Dollars)**

| | | Three months ended June 30, 2020 | | Three months ended June 30, 2019 | | Six months ended June 30, 2020 | | Six months ended June 30, 2019 |
|---|---|---|---|---|---|---|---|---|
| **Net income (loss) for the period** | $ | (13,915) | $ | 675 | $ | (17,076) | $ | 8,091 |
| **Other comprehensive income (loss)** | | | | | | | | |
| ***Items that will not be reclassified to net income*** | | | | | | | | |
| Change in fair value of marketable securities | | 75 | | (159) | | 55 | | (509) |
| ***Items that may be subsequently reclassified to net income*** | | | | | | | | |
| Currency translation adjustment | | 2,424 | | 3,190 | | (21,680) | | (3,358) |
| | | 2,499 | | 3,031 | | (21,625) | | 2,849 |
| **Comprehensive income (loss) for the period** | $ | (11,416) | $ | 3,706 | $ | (38,701) | $ | 10,940 |

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

# LUCARA DIAMOND CORP.

**CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(Unaudited - in thousands of U.S. Dollars)**

| | Three months ended June 30, 2020 | 2019 | Six months ended June 30, 2020 | 2019 |
|---|---|---|---|---|
| **Cash flows from (used in):** | | | | |
| **Operating activities** | | | | |
| Net income (loss) for the period | $ (13,915) | $ 675 | $ (17,076) | $ 8,091 |
| Items not involving cash and cash equivalents: | | | | |
| Depletion and amortization | 8,523 | 12,455 | 19,591 | 24,173 |
| Unrealized foreign exchange (gain) loss | (272) | 1,096 | (637) | 1,264 |
| Share-based compensation | 328 | 430 | 644 | 719 |
| Deferred income taxes | (2,904) | (3,128) | (4,501) | (4,899) |
| Finance costs | 655 | 552 | 1,298 | 1,112 |
| | (7,585) | 12,080 | (681) | 30,460 |
| Net changes in working capital: | | | | |
| VAT receivables and other | 1,591 | 264 | 257 | 5,313 |
| Inventories | (4,726) | (7,111) | (6,821) | (15,263) |
| Trade payables and other current liabilities | (611) | 3,715 | (4,450) | (4,321) |
| Deposits on future sales | 13,500 | - | 13,500 | - |
| Taxes payable | (7,067) | (2,412) | (4,346) | 984 |
| | (4,898) | 6,536 | (2,541) | 17,173 |
| **Financing activities** | | | | |
| Proceeds (repayments) of credit facility, net | - | 5,000 | 19,000 | (5,000) |
| Dividends paid | - | (14,857) | - | (14,857) |
| Withholding tax for share units vested | - | (146) | (8) | (427) |
| Interest paid | (35) | - | (70) | - |
| Principal elements of lease payments | (435) | - | (830) | - |
| | (470) | (10,003) | 18,092 | (20,284) |
| **Investing activities** | | | | |
| Acquisition and disposition of plant and equipment, net | (4,514) | (1,373) | (6,626) | (3,758) |
| Capitalized mineral property expenditure | (3,950) | (4,246) | (5,630) | (8,445) |
| Acquisition of other assets | - | (1,879) | - | (1,879) |
| Development of intangible assets | (2) | (113) | (52) | (309) |
| | (8,466) | (7,611) | (12,308) | (14,391) |
| Effect of exchange rate change on cash and cash equivalents | 109 | 243 | (749) | 251 |
| Increase (decrease) in cash and cash equivalents during the period | (13,725) | (10,835) | 2,494 | (17,251) |
| Cash and cash equivalents, beginning of period | 27,416 | 17,939 | 11,197 | 24,355 |
| **Cash and cash equivalents, end of period**[(1)] | $ 13,691 | $ 7,104 | $ 13,691 | $ 7,104 |

**(Unaudited - in thousands of U.S. Dollars)**

| | | | | |
|---|---|---|---|---|
| **Supplemental information** | | | | |
| Interest received | $ 59 | $ 37 | $ 123 | $ 90 |
| Taxes paid | (4,602) | (2,447) | (4,995) | (4,338) |
| Changes in trade payables and accrued liabilities related to plant and equipment | (8) | 47 | 111 | 1,338 |

[1] Cash and cash equivalents are composed of 100% cash deposits held with accredited financial institutions.

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

## CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

**(Unaudited – in thousands of U.S. Dollars, unless otherwise indicated)**

| | Number of shares issued and outstanding | | Share capital | | Contributed surplus | | Deficit | | Accumulated other comprehensive loss | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance, January 1, 2019** | 396,509,387 | $ | 313,913 | $ | 7,766 | $ | (21,767) | $ | (57,997) | $ | 241,915 |
| Share-based compensation | - | | - | | 719 | | - | | - | | 719 |
| Effect of foreign currency translation | - | | - | | - | | - | | 3,358 | | 3,358 |
| Change in fair value through other comprehensive income securities | - | | - | | - | | - | | (509) | | (509) |
| Shares issued from SUs vested | 348,781 | | 907 | | (907) | | - | | - | | - |
| Withholding tax for SUs vested | - | | - | | (427) | | - | | - | | (427) |
| Dividends paid[(1)] | - | | - | | 43 | | (14,900) | | - | | (14,857) |
| Net income for the period | - | | - | | - | | 8,091 | | - | | 8,091 |
| **Balance, June 30, 2019** | 396,858,168 | $ | 314,820 | $ | 7,194 | $ | (28,576) | $ | (55,148) | $ | 238,290 |
| **Balance, January 1, 2020** | 396,858,168 | $ | 314,820 | $ | 7,679 | $ | (31,494) | $ | (54,070) | $ | 236,935 |
| Share-based compensation | - | | - | | 521 | | - | | - | | 521 |
| Effect of foreign currency translation | - | | - | | - | | - | | (21,680) | | (21,680) |
| Change in fair value through other comprehensive income securities | - | | - | | - | | - | | 55 | | 55 |
| Shares issued from SUs vested | 38,565 | | 104 | | (104) | | - | | - | | - |
| Withholding tax for SUs vested | - | | - | | (8) | | - | | - | | (8) |
| Net loss for the period | - | | - | | - | | (17,076) | | - | | (17,076) |
| **Balance, June 30, 2020** | 396,896,733 | $ | 314,924 | $ | 8,088 | $ | (48,570) | $ | (75,695) | $ | 198,747 |

(1) On April 11 and June 20, 2019, the Company paid a cash dividend of CA$0.025 per share.

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

## 1. NATURE OF OPERATIONS

Lucara Diamond Corp. together with its subsidiaries (collectively referred to as the "Company") is a diamond mining company focused on the development and operation of diamond properties in Africa. The Company holds a 100% interest in the Karowe Mine located in Botswana and a 100% interest in Clara Diamond Solutions Limited Partnership. Clara operates a secure, digital diamond sales platform that uses proprietary analytics together with cloud and blockchain technologies.

The Company's common shares are listed on the TSX, NASDAQ Stockholm and Botswana Stock Exchanges. The Company was continued into the Province of British Columbia under the Business Corporations Act (British Columbia) in August 2004 and its registered office is located at Suite 2600 - 595 Burrard Street, Vancouver, British Columbia, V7X 1L3.

## 2. SIGNIFICANT ACCOUNTING POLICIES, ESTIMATES AND JUDGMENTS

Basis of presentation

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of interim financial statements, IAS 34: Interim Financial Statements, and do not contain all of the information required for annual financial statements. These statements follow the same accounting policies and methods of application as the most recent annual audited financial statements. Accordingly, they should be read in conjunction with the most recent annual audited financial statements of the Company. These financial statements were approved by the Board of Directors for issue on August 10, 2020.

COVID-19 Global pandemic

On March 11, 2020, the World Health Organization declared the novel coronavirus ("COVID-19") a global pandemic and on April 2, 2020 the Government of Botswana declared a state of emergency which is expected to remain in place until September 30, 2020. Between April and July 2020, most governments across the jurisdictions in which Lucara and many of its customers operate declared a state of emergency in response to the COVID-19 pandemic and concern remains over how governments will react in response to a "second wave" until a vaccine can be made widely available. Due to the ongoing uncertainty resulting from the global pandemic, Lucara's operations could continue to be impacted in a number of ways including, but not limited to: a suspension of operations at the Karowe Mine, by disruption to the progress of the Karowe Mine underground expansion project and by an inability to ship or sell rough and/or polished diamonds during this period. These possible impacts could result from government directives, the need to modify work practices to meet appropriate health and safety standards, a lack of demand for rough and/or polished diamonds, a lack of available liquidity to meet ongoing operational expenses and, due to or by other COVID-19 related impacts on the availability of labour or to the supply chain.

As an emerging risk, the duration and full financial effect of the COVID-19 pandemic is unknown at this time, as is the efficacy of government and central bank interventions in the jurisdictions in which Lucara and its clients operate, the Company's business continuity plan and other mitigating measures. While the impact of COVID-19 is expected to be temporary, the current circumstances are dynamic and the impacts of COVID-19 on our business operations, including the duration and impact that it may have on our ability to ship and sell diamonds, on demand for rough and polished diamonds, on our suppliers, on our employees and on global financial markets, cannot be reasonably estimated at this time. Accordingly, estimates of the extent to which the COVID-19 pandemic may materially and adversely affect the Company's operations, financial results and condition in future periods are also subject to significant uncertainty.

(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated.)

In preparing our condensed interim consolidated financial statements, we make judgments in applying our accounting policies. The areas of policy judgement are consistent with those reported in our 2019 annual consolidated financial statements. In addition, we make assumptions about the future in deriving estimates used in preparing our condensed interim consolidated financial statements. As disclosed in Note 3c of the audited consolidated financial statements for the year ended December 31, 2019, the most significant sources of estimation uncertainty include estimated recoverable reserves and resources, valuation of mineral properties, the provision for deferred taxes and the valuation of decommissioning and site restoration provisions.

Management is required to exercise judgment to ensure that disclosures relating to liquidity and the Company's ability to continue as a going concern are appropriate. To this end, the Company manages liquidity risk by maintaining an adequate level of cash and cash equivalents to meet its short-term ongoing obligations and reviews its actual expenditures and forecast cash flows on a regular basis. Changes in demand for rough and/or polished diamonds and diamond prices, production levels and related costs, foreign exchange rates and other factors all impact the Company's liquidity position.

Uncertainty about judgments, estimates and assumptions made by management during the preparation of the Company's condensed interim consolidated financial statements related to potential impacts of the COVID-19 outbreak on revenue, expenses, assets, liabilities, and note disclosures could result in a material adjustment to the carrying value of the asset or liability affected.

## 3. INVENTORIES

| | | **June 30, 2020** | | **December 31, 2019** |
|---|---|---|---|---|
| Rough diamonds | $ | 31,756 | $ | 24,536 |
| Ore stockpile | | 27,554 | | 28,354 |
| Parts and supplies | | 12,132 | | 12,162 |
| | **$** | **71,442** | $ | 65,052 |

Inventory expensed during the six months ended June 30, 2020 totaled $29.3 million (six months ended June 30, 2019 – $33.7 million). There were no inventory write-downs during the six months ended June 30, 2020 and 2019.

During the six months ended June 30, 2020, a deposit of $13.5 million (six months ended June 30, 2019 - $nil) was received as a partial payment for rough diamonds delivered under the terms of a supply agreement with HB Group, a manufacturing company. The initial sale price received for these stones will be based on the estimated polished outcome determined through scanning and planning technology, with a true up paid on actual achieved polished sales thereafter, less a fee and the cost of manufacturing. Revenue will be recognized when the diamonds are sold under the terms of the supply agreement.

(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated.)

## 4. PLANT AND EQUIPMENT

| Cost | Construction in progress | Mine and plant facilities | Vehicles | Furniture and office equipment | Leased assets | Total |
|---|---|---|---|---|---|---|
| **Balance, January 1, 2019** | $ 5,661 | $ 206,424 | $ 2,524 | $ 6,729 | $ - | $ 221,338 |
| IFRS 16 adoption | - | - | - | - | 3,691 | 3,691 |
| Additions | 15,936 | 226 | - | 17 | - | 16,179 |
| Reclassification[1] | (10,331) | 7,596 | 104 | 2,331 | - | (300) |
| Disposals and other | - | - | - | (3) | - | (3) |
| Translation differences | 122 | 2,152 | 26 | 99 | 32 | 2,431 |
| **Balance, December 31, 2019** | $ 11,388 | $ 216,398 | $ 2,654 | $ 9,173 | $3,723 | $ 243,336 |
| Additions | 6,325 | - | - | 7 | 183 | 6,515 |
| Reclassification | (206) | 43 | 18 | 145 | - | - |
| Translation differences | (1,299) | (21,246) | (261) | (900) | (371) | (24,077) |
| **Balance, June 30, 2020** | **$ 16,208** | **$ 195,195** | **$ 2,411** | **$ 8,425** | **$3,535** | **$ 225,774** |
| **Accumulated amortization** | | | | | | |
| **Balance, January 1, 2019** | $ - | $ 68,511 | $ 1,497 | $ 4,084 | $ - | $ 74,092 |
| Depletion and amortization | - | 34,550 | 355 | 1,454 | 1,565 | 37,924 |
| Disposals and other | - | - | - | (3) | - | (3) |
| Translation differences | - | 1,112 | 19 | 65 | 19 | 1,215 |
| **Balance, December 31, 2019** | $ - | $ 104,173 | $ 1,871 | $ 5,600 | $ 1,584 | $ 113,228 |
| Depletion and amortization | - | 14,090 | 126 | 697 | 734 | 15,647 |
| Translation differences | - | (10,939) | (188) | (560) | (177) | (11,864) |
| **Balance, June 30, 2020** | **$ -** | **$ 107,324** | **$ 1,809** | **$ 5,737** | **$ 2,141** | **$ 117,011** |
| **Net book value** | | | | | | |
| As at December 31, 2019 | $ 11,388 | $ 112,225 | $ 783 | $ 3,573 | $ 2,139 | $ 130,108 |
| **As at June 30, 2020** | **$ 16,208** | **$ 87,871** | **$ 602** | **$ 2,688** | **$ 1,394** | **$ 108,763** |

(1) Karowe mine related expenditure of $174 was reclassified to mineral properties and $126 was reclassified to inventory in 2019 from construction in progress.

(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated.)

## 5. MINERAL PROPERTIES

| Cost | Capitalized production stripping asset | Karowe Mine | Total |
|---|---|---|---|
| **Balance, January 1, 2019** | $ 72,352 | $ 73,372 | $ 145,724 |
| Additions | - | 10,320 | 10,320 |
| Reclassification[1] | - | 174 | 174 |
| Translation differences | 676 | 811 | 1,487 |
| **Balance, December 31, 2019** | $ 73,028 | $ 84,677 | $ 157,705 |
| Additions | - | 5,630 | 5,630 |
| Translation differences | (7,234) | (8,545) | (15,779) |
| **Balance, June 30, 2020** | **$ 65,794** | **$ 81,762** | **$ 147,556** |
| **Accumulated depletion** | | | |
| **Balance, January 1, 2019** | $ 11,584 | $ 21,031 | $ 32,615 |
| Depletion | 12,583 | 6,727 | 19,310 |
| Translation differences | 258 | 279 | 537 |
| **Balance, December 31, 2019** | $ 24,425 | $ 28,037 | $ 52,462 |
| Depletion | 4,962 | 2,703 | 7,665 |
| Translation differences | (2,558) | (2,853) | (5,411) |
| **Balance, June 30, 2020** | **$ 26,829** | **$ 27,887** | **$ 54,716** |
| **Net book value** | | | |
| As at December 31, 2019 | $ 48,603 | $ 56,640 | $ 105,243 |
| **As at June 30, 2020** | **$ 38,965** | **$ 53,875** | **$ 92,840** |

(1) Karowe mine related expenditure of $174 was reclassified from plant and equipment to mineral properties in 2019.

*Karowe Mine*

A royalty of 10% of the sales value of diamonds produced from Karowe is payable to the government of Botswana. During the six months ended June 30, 2020, the Company incurred a royalty expense of $4.2 million (2019: $9.1 million).

## 6. INTANGIBLE ASSETS

| | | |
|---|---|---|
| **Cost** | | |
| **Balance, January 1, 2019** | $ | 21,798 |
| Development expenditures | | 404 |
| Translation differences | | 1,001 |
| **Balance, December 31, 2019** | | 23,203 |
| Development expenditures | | 52 |
| Translation differences | | (1,054) |
| **Balance, June 30, 2020** | | **22,201** |

(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated.)

| | | |
|---|---|---|
| **Accumulated Depletion** | | |
| **Balance, January 1, 2019** | $ | - |
| Additions | | (429) |
| **Balance, December 31, 2019** | $ | (429) |
| Additions | | (638) |
| Translation differences | | 13 |
| **Balance, June 30, 2020** | $ | **(1,054)** |
| **Net book value** | | |
| As at December 31, 2019 | $ | 22,774 |
| **As at June 30, 2020** | $ | **21,147** |

In 2018, the Company acquired the Clara platform, a secure, digital sales platform for rough diamonds. The consideration paid was allocated entirely to the intangible assets. As part of the purchase, contingent consideration was agreed to and will be recognized as additional purchase consideration for the intangible asset, if the obliging events occur. The contingent consideration consists of a profit-sharing allocation and additional Lucara share payments if certain revenue triggers are reached.

As of September 1, 2019, management determined that the sales platform was operating as intended. The definite-lived intangible asset is being amortized over the 20 year life of the patents. All income and expenses incurred following September 1, 2019 have been recorded to the statement of operations.

## 7. SHARE BASED COMPENSATION

a. Stock options

The Company's stock option plan (the 'Option Plan') was approved by the shareholders of the Company initially on May 13, 2015, with amendments approved on May 10, 2019. Under the terms of the Option Plan, a maximum of 20,000,000 shares are reserved for issuance upon the exercise of stock options. At the 2020 Shareholder meeting this maximum was subsequently reduced to 10,000,000 shares reserved for issuance upon the exercise of stock options, with the difference allocated for issuance under the Company's share units plans as described in note 7(b) below. The Option Plan provides the Board of Directors with discretion to determine the vesting period for each stock option grant. Options typically vest in thirds over a three-year period beginning on the first anniversary of the date of grant and expire four years from the date of grant.

**(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated.)**

## 7. SHARE BASED COMPENSATION (continued)

Movements in the number of stock options outstanding and their related weighted average exercise prices are as follows:

| | Number of shares issuable pursuant to stock options | Weighted average exercise price per share (CA$) |
|---|---|---|
| **Balance at January 1, 2019** | 4,278,336 | $ 2.40 |
| Granted | 1,437,000 | 1.64 |
| Expired | (703,336) | 2.13 |
| Forfeited | (490,000) | 2.54 |
| **Balance at December 31, 2019** | 4,522,000 | 2.19 |
| Granted | 1,604,000 | 0.77 |
| Expired | (1,480,000) | 2.45 |
| Forfeited | (34,000) | 1.98 |
| **Balance at June 30, 2020** | **4,612,000** | **$ 1.61** |

Options to acquire common shares have been granted and are outstanding at June 30, 2020 as follows:

| | Outstanding Options | | | Exercisable Options | | |
|---|---|---|---|---|---|---|
| Range of exercise prices CA$ | Number of options outstanding | Weighted average remaining contractual life (years) | Weighted average exercise price (CA$) | Number of options exercisable | Weighted average remaining contractual life (years) | Weighted average exercise price (CA$) |
| $0.50 - $1.00 | 1,604,000 | 3.67 | 0.77 | - | - | - |
| $1.51 - $2.00 | 1,413,000 | 2.66 | 1.64 | 471,000 | 2.66 | 1.64 |
| $2.01 - $2.50 | 1,220,000 | 1.80 | 2.33 | 740,000 | 1.77 | 2.34 |
| $2.51 - $3.00 | 375,000 | 0.76 | 2.76 | 358,333 | 0.74 | 2.77 |
| | **4,612,000** | **2.63** | **$ 1.61** | **1,569,333** | **1.80** | **$ 2.23** |

During the six months ended June 30, 2020, an amount of $0.2 million (2019 – $0.2 million) was charged to operations in recognition of share-based compensation expense, based on the vesting schedule for the options granted.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions and resulting values for grants as follows:

| | **2020** | **2019** |
|---|---|---|
| Assumptions: | | |
| Risk-free interest rate *(%)* | 1.33 | 1.82 |
| Expected life *(years)* | 3.63 | 3.63 |
| Expected volatility *(%)* | 35.04 | 38.20 |
| Expected dividend | Nil | CA$0.025/share quarterly |
| Results: | | |
| Weighted average fair value of options granted *(per option)* | CA$0.21 | CA$0.30 |

(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated.)

## 7. SHARE BASED COMPENSATION (continued)

b. Restricted and performance share units

The Company has a share unit ('SU') plan that provides for the issuance of SUs as a long-term incentive for certain members of the management team. Amendments to the SU plan, including a reallocation of 10,000,000 common shares now reserved for issuance upon the vesting of share units (from the pool originally allocated for the exercise of stock options) were approved by Shareholders at the May 8, 2020 annual meeting. SUs vest three years from the date of grant and certain share units include performance metrics. Each SU entitles the holder to receive one common share and the cumulative dividend equivalent SU earned during the SU's vesting period. The value of each SU at the vesting date is equal to the closing value of one Lucara common share plus the cumulative dividend equivalent which was earned over the vesting period.

For the six month period ended June 30, 2020, the Company recognized a share-based payment charge against income of $0.3 million (2019: $0.5 million) for the SUs granted during the period.

| | Number of share units | Estimated fair value at date of grant (CA$) | |
|---|---|---|---|
| **Balance at December 31, 2018** | 1,283,045 | $ | 2.41 |
| February 25, 2019 grant | 439,000 | | 1.63 |
| February 26, 2019 vesting | (445,567) | | 2.57 |
| April 2, 2019 vesting | (247,393) | | 2.52 |
| April 11, 2019 dividend | 19,822 | | 1.61 |
| April 11, 2019 vesting | (3,841) | | 1.61 |
| June 20, 2019 dividend | 16,641 | | 1.57 |
| September 19, 2019 dividend | 23,283 | | 1.14 |
| **Balance at December 31, 2019** | 1,084,990 | $ | 1.95 |
| February 26, 2020 grant | 1,918,000 | | 0.77 |
| March 8, 2020 vesting | (56,463) | | 2.57 |
| **Balance at June 30, 2020** | **2,946,527** | **$** | **1.17** |

c. Deferred share units

In February 2020, the Company approved a deferred share unit ('DSU') plan that provides for the issuance of up to 4,000,000 DSUs for eligible directors; the DSU plan was subsequently ratified by Shareholders at the May 8, 2020 annual meeting. Directors can elect to receive up to 100% of their fees earned in DSUs. DSUs vest immediately and are paid out upon retirement from the Board of Directors of the Company. Each DSU entitles the holder to receive one common share and the cumulative dividend equivalent DSU earned prior to the payout date. The value of each DSU at the grant date is equal to the closing value of one Lucara common share. The DSU plan is a cash-settled share-based compensation plan and is recorded as a liability. Upon payout, the director can elect to receive the value in cash or common shares of the Company.

| | Number of share units | Estimated fair value (CA$) | |
|---|---|---|---|
| February 26, 2020 grant | 278,000 | $ | 0.77 |
| May 7, 2020 vesting | (74,000) | | 0.51 |
| **Balance at June 30, 2020** | **204,000** | **$** | **0.62** |

(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated.)

## 7. SHARE BASED COMPENSATION (continued)

For the six month period ended June 30, 2020, the Company recognized a share-based payment charge against income of $0.2 million (2019: $nil million) for the DSUs granted during the period.

## 8. ADMINISTRATION

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2020** | **2019** | **2020** | **2019** |
| Salaries and benefits | $ 1,264 | $ 1,562 | $ 2,664 | $ 2,392 |
| Professional fees | 348 | 669 | 818 | 1,057 |
| Office and general | 831 | 410 | 1,438 | 892 |
| Marketing | 124 | 197 | 376 | 414 |
| Stock exchange, transfer agent, shareholder communication | 39 | 93 | 190 | 217 |
| Travel | 98 | 199 | 276 | 367 |
| Share-based compensation (Note 7) | 328 | 430 | 644 | 719 |
| Management fees | 71 | 123 | 169 | 247 |
| Depreciation | 550 | 263 | 1,127 | 356 |
| Donations | - | 14 | 22 | 76 |
| | **$ 3,653** | $ 3,960 | **$ 7,724** | $ 6,737 |

## 9. RELATED PARTY TRANSACTIONS

*a) Key management compensation*

Key management personnel are those persons having the authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly. Key management personnel include the Company's named executive officers and members of its Board of Directors. The remuneration of key management personnel was as follows:

| | Six months ended June 30, | |
|---|---|---|
| | **2020** | **2019** |
| Salaries and wages | $ 796 | $ 905 |
| Short term benefits | 20 | 51 |
| Share based compensation | 457 | 361 |
| | $ 1,273 | $ 1,317 |

*b) Clara acquisition*

At the time of Lucara's acquisition of Clara, certain directors and officers of the Company were also shareholders of Clara. If certain milestones are reached, these individuals will receive additional common shares of Lucara as described in Note 16 of the consolidated financial statements for the year ended December 31, 2019. Pursuant to a profit sharing described in Note 16 of the consolidated financial statements for the year ended December 31, 2019, a portion of the EBITDA generated by the platform has been assigned to two directors of Lucara, each of whom was a founder of Clara, and a portion may be distributed to members of management, at the discretion of Lucara's Compensation Committee, based on the achievement of key performance targets. As at June 30, 2020, no amounts have been recorded under this profit sharing mechanism.

**(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated.)**

## 10. SEGMENT INFORMATION

The Company's primary business activity is the development and operation of diamond properties in Africa. The Company has two operating segments: Karowe Mine and Corporate and other.

**Three months ended June 30, 2020**

| | Karowe Mine | Corporate and other | Total |
|---|---|---|---|
| Revenues | $ 7,336 | $ 126 | $ 7,462 |
| Loss from mining operations[1] | (13,041) | (223) | (13,264) |
| Exploration expenditures | (493) | - | (493) |
| Finance expenses | (697) | (102) | (799) |
| Foreign exchange gain (loss) | 298 | (26) | 272 |
| Other | (1,937) | (2,326) | (4,263) |
| Taxes | 4,632 | - | 4,632 |
| **Net loss for the period** | **(11,238)** | **(2,677)** | **(13,915)** |
| **Capital expenditures** | **$ 8,159** | **$ 2** | **$ 8,161** |

**Three months ended June 30, 2019**

| | Karowe Mine | Corporate and other | Total |
|---|---|---|---|
| Revenues | $ 42,541 | $ - | $ 42,541 |
| Income from mining operations[1] | 8,505 | - | 8,505 |
| Exploration expenditures | (953) | - | (953) |
| Finance expenses | (711) | (127) | (838) |
| Foreign exchange loss | (267) | (172) | (439) |
| Other | (1,553) | (2,955) | (4,508) |
| Taxes | (1,092) | - | (1,092) |
| Net income (loss) for the period | 3,929 | (3,254) | 675 |
| Capital expenditures | $ (5,619) | $ (113) | $ (5,732) |

[1] Karowe Mine's depletion and amortization expense during the three months ended June 30, 2020 totaled $8.0 million (three months ended June 30, 2019 – $12.1 million).

**(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated.)**

## 10. SEGMENT INFORMATION (continued)

**Six months ended June 30, 2020**

| | Karowe Mine | Corporate and other | Total |
|---|---|---|---|
| Revenues | $ 41,115 | $ 464 | $ 41,579 |
| Loss from mining operations(1) | (10,138) | (277) | (10,415) |
| Exploration expenditures | (1,085) | - | (1,085) |
| Finance expenses | (1,460) | (179) | (1,639) |
| Foreign exchange gain (loss) | 789 | (152) | 637 |
| Other | (3,719) | (5,105) | (8,824) |
| Taxes | 4,250 | - | 4,250 |
| **Net loss for the period** | **(11,363)** | **(5,713)** | **(17,076)** |
| **Capital expenditures** | **$ 12,256** | **$ 52** | **$ 12,308** |
| **Total assets** | **$ 296,085** | **$ 25,061** | **$ 321,146** |

**Six months ended June 30, 2019**

| | Karowe Mine | Corporate and other | Total |
|---|---|---|---|
| Revenues | $ 91,231 | $ - | $ 91,231 |
| Income from mining operations(1) | 24,660 | - | 24,660 |
| Exploration expenditures | (2,002) | - | (2,002) |
| Finance expenses | (1,297) | (343) | (1,640) |
| Foreign exchange loss | (1,070) | (194) | (1,264) |
| Other | (3,135) | (4,677) | (7,814) |
| Taxes | (3,851) | - | (3,851) |
| Net income (loss) for the period | 13,304 | (5,214) | 8,091 |
| Capital expenditures | $ (12,203) | $ (309) | $ (12,512) |
| Total assets | $ 327,644 | $ 27,765 | $ 355,409 |

(1) Karowe Mine's depletion and amortization expense during the six months ended June 30, 2020 totaled $18.5 million (six months ended June 30, 2019 – $23.7 million).

## 11. FINANCIAL INSTRUMENTS AND CAPITAL MANAGEMENT

a) *Measurement categories and fair values*

Financial assets and liabilities have been classified into categories that determine their basis of measurement. Those categories are: fair value through profit and loss; fair value through other comprehensive income and amortized cost.

The value of the Company's financial instruments at fair value through other comprehensive income is derived from quoted prices in active markets for identical assets. The fair value of all other financial instruments of the Company approximates their carrying values because of the demand nature or short-term maturity of these instruments.

**(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated.)**

## 11. FINANCIAL INSTRUMENTS AND CAPITAL MANAGEMENT (continued)

b) *Fair value hierarchy*

The following table classifies financial assets and liabilities that are recognized on the balance sheet at fair value in a hierarchy that is based on significance of the inputs used in making the measurements. The levels in the hierarchy are:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.
Level 2 - Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).
Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

| | June 30, 2020 | December 31, 2019 |
|---|---|---|
| Level 1: Fair value through other comprehensive income – Investments | $ 295 | $ 241 |
| Level 2: N/A | | |
| Level 3: N/A | | |

c) *Financial risk management*

The Company's financial instruments are exposed to certain financial risks, including currency, credit, liquidity and price risks.

*Currency risk*

The Company is exposed to the financial risk related to fluctuating foreign exchange rates. All sales revenues are denominated in U.S. dollars, while directly related costs are denominated in Botswana Pula. At June 30, 2020, the Company is exposed to currency risk relating to U.S. dollar cash held within its subsidiaries with Canadian or Pula functional currency. Based on this exposure, a 10% change in the U.S. dollar exchange rate would give rise to an increase/decrease of approximately $1.1 million in net income for the year.

*Credit risk*

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. A majority of the Company's cash and cash equivalents are held through a large Canadian financial institution with a high investment grade rating. Considering the nature of the Company's ultimate customers and the relevant terms and conditions entered into with such customers, the Company believes that credit risk is limited as goods are not released until full payment is received.

Under the new supply agreement disclosed in Note 3, a larger proportion of the Company's goods will be sold through the HB Group to polished buyers. The credit risk associated with these sales will concentrate with one individual customer and payment terms are longer (60 days) than the Company's traditional tender sales (5 days).

The carrying amount of financial assets recorded in the financial statements, net of any allowance for losses, represents the Company's maximum exposure to credit risk.

*Price risk*

The Company derives its income from the sale of rough diamonds mined in Botswana, a majority of which are sold through a quarterly tender process from Botswana. The price and marketability of these diamonds can be significantly impacted by international economic trends, global or regional consumption, demand and supply patterns and the availability of capital for diamond manufacturers,

## 11. FINANCIAL INSTRUMENTS AND CAPITAL MANAGEMENT (continued)

all factors that are not within the Company's control. Under the supply agreement (Note 3), the ultimate achieved sales prices of stones larger than 10.8 carats in size will be based on a polished diamond pricing mechanism. This pricing mechanism will result in the Company's revenue being exposed to a greater extent to the price movements in the polished diamond market than it is currently through its traditional tender process. The COVID-19 pandemic has negatively impacted global demand for luxury commodities, which includes jewelry containing diamonds. Restrictions on international travel have also disrupted the diamond supply chain. To the extent that the supply of rough or polished diamonds exceeds demand, this is likely to result in price deterioration and negatively impact the Company's revenue, thereby increasing the risk that not only will operations not be profitable, the Company may not have sufficient liquidity to meet its financial obligations as they come due.

*Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. To manage liquidity risk, regular cash flow forecasting is performed in the operating entities of the Company and aggregated in the head office to understand what level of capital is required. Rolling forecasts of the Company's liquidity requirements are prepared and monitored to assess whether there is sufficient cash available to meet the Company's short and longer-term operational needs. Such forecasting takes into consideration the Company's ability to generate cash from the sale of diamonds and additional liquidity which can be accessed through the revolving term credit facility.

*Revolving credit facility*

The Company holds a $50 million revolving term credit facility with the Bank of Nova Scotia with a maturity date of May 5, 2020. In April 2020, this facility was extended for one year to May 5, 2021. Funds drawn under the revolving credit facility are due in full at maturity. The facility contains financial and non-financial covenants customary for a facility of this size and nature. As part of the extension, and until Lucara obtains greater clarity on its cash flow projections in the short-term, Lucara has agreed to limit capital expenditures related to the underground expansion project. In June 2020, the Bank of Nova Scotia agreed to amend the minimum level of tangible net worth required to be maintained by the Company to $200 million. As at June 30, 2020, the Company was in compliance with all financial and non-financial covenants. Outstanding amounts under the facility bear interest at LIBOR or an alternative base rate plus an applicable margin based on the Company's adjusted leverage ratio.

The Company has provided security on the facility by way of a charge over the Company's Karowe assets and a guarantee by the Company's subsidiaries, which hold the Karowe assets.

As at June 30, 2020, $19.0 million was drawn on the facility for working capital purposes (2019 - $nil) and $31.0 million was available to be drawn.