LUCARA

DIAMOND

# Management's Discussion and Analysis

and

# Consolidated Financial Statements

Year Ended December 31, 2019

**LUCARA DIAMOND CORP.**
**ANNUAL MANAGEMENT'S DISCUSSION AND ANALYSIS**
**December 31, 2019**

Management's discussion and analysis ("MD&A") focuses on significant factors that have affected Lucara Diamond Corp. (the "Company") and its subsidiaries performance 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 audited consolidated financial statements of the Company for the year ended December 31, 2019, which are prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). 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 February 23, 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".

## HIGHLIGHTS

- Total revenues of $192.5 million (2018: $176.2 million) or $468 per carat (2018: $502 per carat) during fiscal year 2019 (guidance: $170 million to $180 million).

- Strong operational performance at Karowe, including record production through the plant in 2019:

  - Total tonnes mined of 9.8 million (guidance: 9.5 million to 10.9 million)
  - Ore and waste mined were 3.3 million tonnes and 6.5 million tonnes respectively
  - Ore processed totaled 2.8 million tonnes (guidance: 2.5 million to 2.8 million tonnes)
  - 433,060 total carats recovered, including 29,990 carats recovered from previously milled material (guidance: 400,000 to 425,000 carats)

- 2019 was another strong year for the recovery of Specials (single diamonds in excess of 10.8 carats) from direct milling ore with 786 stones totaling 24,424 carats recovered, including 31 diamonds in excess of 100 carats, of which 2 stones were in excess of 300 carats including the historic 1,758ct Sewelô diamond. Specials were also recovered in treatment of historic, pre-XRT recovery tailings, including a 375 ct stone in Q3 2019. No further treatment of historic recovery tailings is expected.

- Operating cash costs for the year ended December 31, 2019 were $31.88 per tonne processed (2018: $39.92 per tonne processed) compared to the full year forecast cash cost of $32-$37 per tonne processed (see page 10 Non-IFRS measures). Operating cash cost per tonne processed was positively impacted by a combination of higher tonnes processed and lower overall tonnes mined as planned in 2019 following the completion of a waste stripping campaign in 2018. Cost optimization initiatives and favorable foreign exchange contributed to the lower operating cash cost per tonne compared to guidance. Operating cash costs for 2020 are expected to continue to trend between $32-$36 per tonne processed.

- Clara completed its first year of operations with a total of 15 sales, 27 customers and volume transacted of $8.4 million. Development activities were completed under budget at $0.4 million in 2019. Clara is poised to achieve significant growth in 2020 with the addition of further customers and third-party production.

- Adjusted EBITDA for the year ended December 31, 2019 was $73.1 million as compared to adjusted EBITDA for the same period in 2018 of $60.5 million, an increase of 21% (see page 10 Non-IFRS measures).

- Net income for the year ended December 31, 2019 was $12.7 million ($0.03 per share) as compared to net income of $11.7 million ($0.03 per share) in 2018.

- As at December 31, 2019, the Company had cash and cash equivalents of $11.2 million and no debt. In 2019, the Company invested $29.0 million in the business, primarily towards the completion of an underground feasibility study, and, improvements to plant and equipment to maximize carat recoveries. The Company's $50 million credit facility was available for use as at December 31, 2019.

- During the first three quarters of 2019, the Company paid a CA$0.025 quarterly dividend, returning $22.4 million (CA$0.075 per share) to shareholders in 2019 (2018: $30.3 million or CA$0.10 per share). Since inception in June 2014, the Company has paid dividends of $271 million (CA$349 million).

## CHANGE IN DIVIDEND POLICY

In November 2019, the Company announced the results of a positive feasibility study for development of an underground mine at its 100% owned Karowe Diamond Mine. Concurrently with the announcement of the feasibility study, Lucara's Board of Directors determined that it would be in the best interest of the Company and its shareholders to suspend the quarterly dividend payment of C$0.025 per share, effective as of Q4 2019. The feasibility study demonstrated the potential to extend the mine life at Karowe to 2040 while generating significant economic benefits for the Company, its shareholders, employees, the communities surrounding the mine and the country of Botswana. In anticipation of a decision to proceed with construction of an underground mine at Karowe during 2020, the Board of Directors decided to re-direct the Company's available cash to the early works on the underground including detailed engineering, procurement initiatives and project financing. These activities will be funded from operating cash flow in 2020, under a Board approved budget of up to $53 million.

## KAROWE DIAMOND SALES

Diamonds are heterogeneous by nature, with thousands of different price points depending on weight, colour, shape, and quality. Diamond production from Karowe is characterised by a coarse diamond size frequency distribution and is positively impacted by the regular recovery of diamonds in excess of 10.8 carats in size, referred to as "Specials." Karowe production is further distinguished by the consistent recovery of high value, gem quality Specials.

Specials are reported by total stone count and as a percentage of the total production. In 2019, a total of 786 stones were recovered representing 6.1 weight percent of total carats recovered from direct milling ore, consistent with the resource model for Karowe. Overall processing in 2019 had contributions from the North, Centre and both the EM/PK(S) and M/PK(S), distinct units within the South lobe. The proportion of carats from the lower value and less coarse North and Centre lobes was approximately 20%, the highest contribution since 2016.

Diamond prices are driven by: weight, colour, quality (cracks and inclusions) and shape (yield). In 2019, a total of 30 individual diamonds were sold for a value of > $1 million including 11 diamonds > $2 million of which 2 diamonds sold for > $5 million each. Sales of individual stones at prices between $2 million and $5 million were consistent with previous years. Achieved prices in 2019 for high value single diamonds were impacted by significant price erosion in high colour (D) 10 carat and 20 carat polished.

Certain stones from the Karowe production and other aggregated diamonds were offered for sale through the Clara platform during 2019. As 2020 progresses, a greater proportion of certain sales parcels from Karowe will move to the Clara platform, rather than being sold through the quarterly tender process.

**FINANCIAL HIGHLIGHTS**

**Table 1:**

| *In millions of U.S. dollars, except carats or otherwise noted* | **Three months ended December 31** **2019** | 2018 | **Year ended December 31** **2019** | 2018 |
|---|---|---|---|---|
| Revenues | $ 56.0 | $ 40.6 | $ 192.5 | $ 176.2 |
| Net income (loss) for the period | 8.7 | (6.2) | 12.7 | 11.7 |
| Earnings (loss) per share (basic and diluted) | 0.02 | (0.02) | 0.03 | 0.03 |
| Operating cash flow per share* | 0.05 | 0.02 | 0.15 | 0.14 |
| Cash on hand | 11.2 | 24.4 | 11.2 | 24.4 |
| Average price per carat sold ($/carat)* | 568 | 367 | 468 | 502 |
| Operating expenses per carat sold ($/carat)* | 209 | 233 | 189 | 216 |
| Operating margin per carat sold ($/carat)* | 359 | 134 | 279 | 286 |
| Carats sold | 98,547 | 110,553 | 411,732 | 350,798 |

(*) 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 3: Results of Operations for reconciliations and page 10 for Non-IFRS measures.

The Company achieved revenues of $56.0 million or $568 per carat for its sales in the fourth quarter, yielding a strong operating margin of 63% during the period. During the fourth quarter of 2019, stabilization in rough pricing was observed across all size classes. The general improvement in pricing as compared to earlier in the year, combined with a higher value blend of ore to the process plant resulted in revenue for the quarter and for the year ending December 31, 2019 being achieved above expectations. The increase in average price per carat sold, along with a 10% decrease in operating expenses per carat sold, resulted in an operating margin of 63% in Q4 2019; this represents a significant improvement from the 36% operating margin achieved in Q4 2018.

Operating expenses decreased approximately 20% from $25.8 million in Q4 2018 to $20.6 million in Q4 2019, mostly due to a decrease in the average cost per tonne mined. Operating expenses in Q4 2018 included additional one-time costs following the transition between mining contractors during the third quarter of 2018.

Adjusted EBITDA increased from $4.7 million in Q4 2018 to $22.8 million in Q4 2019. The significant quarter-to-quarter increase resulted from the combination of a $13.9 million increase in net revenue and a $5.2 million decrease in operating expenses (see page 10 Non-IFRS measures).

Adjusted EBITDA (see page 10 Non-IFRS measures), earnings per share and the Company's ending cash position were as expected and reflect the overall performance of the Company's sales tenders.

## SELECT ANNUAL FINANCIAL INFORMATION

| **Table 2:**<br>*In millions of U.S. dollars unless otherwise noted* | **Year ended December 31,**<br>**2019** | 2018 | 2017 |
|---|---|---|---|
| Revenues | $ 192.5 | $ 176.2 | $ 220.8 |
| Operating expenses | (77.7) | (75.7) | (61.9) |
| **Operating earnings** [(1)] | **114.8** | **100.5** | **158.9** |
| Royalty expenses | (19.2) | (17.6) | (22.1) |
| Exploration expenditures | (4.6) | (3.4) | (4.8) |
| Administration | (15.7) | (16.4) | (15.2) |
| Sales and marketing | (2.2) | (2.6) | (3.3) |
| **Adjusted EBITDA** [(2)] | **73.1** | **60.5** | **113.5** |
| Depletion and amortization | (51.3) | (31.4) | (15.3) |
| Finance expenses | (3.1) | (2.6) | (2.4) |
| Foreign exchange loss | (2.6) | (2.3) | (5.6) |
| Gain on contractor settlement | - | - | 7.0 |
| Current income tax expense | (14.5) | (5.9) | (14.8) |
| Deferred income tax expense (recovery) | 11.0 | (6.7) | (17.3) |
| **Net income for the year** | **12.7** | **11.6** | **65.1** |
| | | | |
| **Earnings per share (basic)** | **0.03** | **0.03** | **0.17** |
| **Earnings per share (diluted)** | **0.03** | **0.03** | **0.17** |
| | | | |
| **Per carat sold:** | | | |
| **Sales price** | **$ 468** | **$ 502** | **$ 847** |
| **Operating expenses** | **189** | **216** | **238** |
| | | | |
| **Average grade processed (carats per hundred tonnes)** [(3)] | **14.4** | **13.9** | **10.7** |
| | | | |
| **Cash on hand** | **$ 11.2** | **$ 24.4** | **$ 61.1** |
| **Total assets** | **346.0** | **370.1** | **365.8** |
| **Total non-current financial liabilities** | **87.5** | **93.7** | **91.9** |
| **Change in cash during the year** | **(13.2)** | **(36.7)** | **7.7** |
| **Dividends paid during the year** | **(22.4)** | **(30.3)** | **(29.4)** |

(1) Operating earnings is a non-IFRS measure defined as revenues less operating expenses.
(2) Adjusted EBITDA is a non-IFRS measure 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*

Total sales of $192.5 million in 2019 increased by 9.3% from 2018, despite challenging market conditions for the industry. This marks the second year of continued revenue growth over the previous three years, from total sales of $176.2 million in 2018 and $167.8 million in 2017 (after adjusting for the sale of the exceptional Lesedi La Rona ("LLR") for $53 million). During the year ended December 31, 2019, Lucara sold 411,732 carats at an average price of $468 per carat. During the year ended December 31, 2018, Lucara sold 350,798 carats at an average price of $502 per carat. Continued improvements in the process plant including better plant availability, an increasing mine call factor, and stable operations have led to an increase in the number of diamonds recovered. Total sales of $192.5 million in 2019 include sales of Karowe diamonds through the Clara platform.

Revenue achieved of $192.5 million exceeded revised 2019 revenue guidance of $170 million to $180 million due to a strong fourth quarter tender, which included a number of higher value single stones and a general improvement in pricing across all size classes.

### *Operating Earnings and Expenses*

Operating earnings for the year ended December 31, 2019 were $114.8 million (2018: $100.5 million) after operating expenses of $77.7 million or $189 per carat sold (2018: operating expenses of $75.7 million or $216 per carat sold), which resulted in an operating margin (before royalties, depletion and amortization) of $279 per carat or 60% (2018: operating margin of $286 per carat or 57%). The increase in operating earnings is directly attributable to the 9% increase in revenue. Total operating expenses, while appearing similar, reflect an overall decrease as 2018 saw the completion of a large waste stripping campaign in which a portion of operating expenses was capitalized to mineral properties. While the average price per carat sold was lower in 2019, the decrease in operating expense per carat led to an increased operating margin per carat sold from 57% in 2018 to 60% in 2019. An increase in total carats sold of approximately 17% from 2018 (350,798 carats) to 2019 (411,732 carats) was also a factor in the improved operating margins achieved in 2019.

Lucara achieved an average grade of 14.4 carats per hundred tonnes ("cpht") during the year compared to an average grade of 13.9 cpht in the prior year. In addition, carat recoveries of 403,070 carats, excluding 29,990 carats recovered from re-processing of historic tailings (2018: 366,086 carats recovered) increased by 10% as compared to 2018. The increase in carat recoveries continues to be in the smaller sizes which reduces the average price per carat sold without materially increasing total revenue.

### *Depletion and amortization*

In 2019, the Company recorded depletion and amortization expense of $51.3 million (2018: $31.4 million, 2017: $15.3 million). The material increase in this non-cash expense year over year is due to several factors: i) a change in the reserve base following an update to the Mineral Resource Estimate mid-2018, ii) a significant increase in the number of carats sold during the year (2019: 411,732 carats sold; 2018: 350,798 carats sold; 2017: 260,526 carats sold), and iii) a higher asset base following the capitalized production stripping campaign between 2017 and 2018. Depletion expense on assets that are amortized on a unit of production basis, including stripping costs, is more significantly affected by the volume of carats recovered in any given year. A 17% increase in the number of carats sold in 2019 follows a 35% increase in the number of carats sold during 2018 compared to 2017. This compounding increase in the number of carats recovered and sold results in a significant impact to depletion and amortization expense which is recorded on a per unit basis, irrespective of the revenue generated per carat.

### *Net income*

Net income for the year ended December 31, 2019 was $12.7 million (2018: $11.6 million). Higher revenue is offset by materially higher depletion and amortization expense (+63%) resulting in similar net income as compared to the year ended December 31, 2018.

### *Adjusted Earnings Before Interest, Tax, Depreciation and Amortization (Adjusted EBITDA)*

Adjusted EBITDA for the year ended December 31, 2019 was $73.1 million compared to $60.5 million in 2018. The 21% period to period change is mainly attributable to the increase in revenue in 2019.

Adjusted EBITDA is a non-IFRS measure and is reconciled in table 2 above.

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

For the year ended December 31, 2019, operating cost per tonne processed was $31.88 (2018: $39.92). This decrease is largely attributable to the completion of the waste stripping campaign in 2018 resulting in a lower overall volume of ore and waste tonnes mined (2019: 9.8 million tonnes; 2018: 18.1 million tonnes) as well as a 7% increase in tonnes processed. A continued increase in rough diamond inventory (2019: +$3.8 million; 2018: +$0.6 million) offset a portion of the decreased operating cost per tonne processed. Operating cost per tonne processed was below guidance of $32-37 due to a higher volume of ore processed, cost optimization initiatives, and a favourable foreign exchange rate.

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

**QUARTERLY RESULTS OF OPERATIONS – KAROWE MINE**
**Table 3: Karowe Diamond Mine, Botswana**

| | UNIT | Q4-19 | Q3-19 | Q2-19 | Q1-19 | Q4-18 |
|---|---|---|---|---|---|---|
| **Sales** | | | | | | |
| Revenues generated from sales tenders conducted in the quarter | US$M | 56.0 | 45.3 | 42.5 | 48.7 | 40.6 |
| Carats sold for revenues recognized during the period | Carats | 98,547 | 116,200 | 101,931 | 95,057 | 110,553 |
| Average price per carat for proceeds received during the period | US$ | 568 | 390 | 417 | 512 | 367 |
| **Production** | | | | | | |
| Tonnes mined (ore) | Tonnes | 694,591 | 823,875 | 773,861 | 1,011,048 | 563,279 |
| Tonnes mined (waste) | Tonnes | 740,593 | 1,489,668 | 1,826,972 | 2,485,548 | 2,743,586 |
| Tonnes processed | Tonnes | 647,502 | 680,665 | 713,037 | 763,313 | 602,376 |
| Average grade processed | cpht (*) | 13.3[1] | 13.9[2] | 14.2[3] | 15.9[4] | 13.6[5] |
| Carats recovered | Carats | 86,422[1] | 104,990[2] | 109,312[3] | 132,336[4] | 81,850[5] |
| **Costs** | | | | | | |
| Operating costs per carats sold (see page 10 Non-IFRS measures) | US$ | 209 | 201 | 174 | 169 | 233 |
| Capital expenditures | US$M | 13.0 | 0.7 | 1.4 | 2.4 | 6.5 |

(*) 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.
(4) Carats recovered during the period included 10,899 carats recovered from re-processing historic recovery tailings from previous milling and are excluded from the average grade processed.
(5) Carats recovered during the period included 1,505 carats recovered from re-processing historic recovery tailings from previous milling and are excluded from the average grade processed.

**FOURTH QUARTER OVERVIEW – OPERATIONS - KAROWE DIAMOND MINE**

**Safety:** Karowe had one lost time injury during the three months ended December 31, 2019 resulting in a twelve-month rolling Lost Time Injuries Frequency Rate (“LTIFR”) of 0.78.

**Production**: Ore and waste mined during the fourth quarter of 2019 totaled 0.7 million tonnes and 0.7 million tonnes respectively. Tonnage processed was on target at 0.6 million tonnes, with a total of 86,422 carats recovered. Ore processed was predominantly from the South Lobe. During Q4, a total of 177 Specials (single diamonds larger than 10.8 carats) were recovered including seven diamonds greater than 100 carats in weight and two diamonds greater than 200 carats. Recovered Specials equated to 6.1% weight percentage of total recovered carats during the year, the third year to achieve greater than 6% weight percentage of total recovered carats, in line with expectations.

A record 2.8 million tonnes of ore were processed during 2019, at the top end of 2019 guidance of 2.5 to 2.8 million tonnes. A total of 3.3 million tonnes of ore was mined for the year, surpassing the original guidance of 2.5 – 2.8 million tonnes and meeting revised guidance of 3.0 – 3.4 million tonnes. Following the transition to a new mining contractor in mid-2018, productivity performance improved considerably and continued through 2019. Beginning in the fourth quarter of 2018, Trollope Mining Services Pty (“Trollope”) was responsible for all waste and ore mining.

**Karowe’s operating cash cost:** Karowe’s full year 2019 operating cash cost (see page 10 Non-IFRS measures) was $31.88 per tonne processed (2018: $39.92 per tonne processed) compared to the full year forecast of $32-37 per tonne processed. The decrease in cost per tonne processed compared to the prior year comparable periods reflects a 7% increase in total tonnes processed, a favourable exchange rate and cost optimization of the operations offsetting an increase in the cost per tonne mined following the transition to a new mining contractor in mid-2018.

**Labour relations**: In April 2019, the Botswana Mine Workers Union and Lucara Botswana entered into a Memorandum of Agreement which governs the working relationship between the two parties. In May 2019, the parties successfully negotiated and signed a Salaries and Conditions of Service Agreement which covers the terms and conditions of employment, including wages, to March 31, 2021. In Botswana, a majority of currently operating mines are unionized.

## KAROWE UNDERGROUND UPDATE

*Karowe Underground Update*

In 2018, the Company embarked on a technical program to support a feasibility level study for a potential underground operation at the Karowe Diamond Mine. This program included the completion of an updated mineral resource, geotechnical drilling of the country rock and AK06 kimberlite, hydrogeological drilling and modelling, and mining trade off studies to address risks and issues identified during the PEA. A total of $21.0 million was spent in 2018 in support of this work, which resulted in significant de-risking of the key technical components associated with the potential underground development.

During 2019, $13.4 million ($14.8 million - 2019 budget) was spent on the completion of a geotechnical drilling program, geotechnical and geological logging, downhole geophysical survey, hyperspectral analysis of core, geotechnical modeling, hydrogeological drilling and studies, mine planning, engineering, and activities related to dewatering associated with underground preparations.

On November 4, 2019, the Company announced the results of a Feasibility Study ("FS") 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* ("NI 43-101") were filed on Sedar (www.sedar.com) and are available on the Company's website at: www.lucaradiamond.com.

Key findings of the FS include:

- The FS outlines the potential to double the mine life from the original mine design of 2010 and add net cash flow of $1.22 billion and gross revenue of $5.25 billion.
- Updated resource confirms increasing value with depth. Indicated resource from the base of the current open pit to the 250 metres above sea level elevation is 35 million tonnes at a grade of 15 cpht for a contained diamond resource of 5.1 million carats.
- Long hole shrinkage underground bulk mining method was selected, providing early access to higher value ore and allows for a short pay-back period of 2.8 years and operating costs of $28.43 per tonne processed.
- On the basis of a construction start in mid-2020, ore from underground mining will seamlessly integrate into current operations providing mill feed starting in 2023 with a ramp up to 2.7Mtpa to the processing plant by 2026, and the opportunity to increase throughput after 2029. Current production rates will be maintained through the underground ramp up period.
- The underground is designed to access the South Lobe kimberlite resource below the current planned bottom of the open pit (which is expected to be at approximately 700 meters above sea level ("masl")), to a depth of 310 masl. Access to the South Lobe underground will be via two vertical shafts (production and ventilation) of approximately 765 and 715 meters deep respectively.
- Identified key risk areas of hydrogeology, geotechnical constraints of the kimberlite and host rocks have been addressed through an intensive set of work programs, data collection, analysis, and modelling.

*Next steps:* Following completion of the FS during the 4th quarter of 2019, the focus of work shifted to project execution, including detailed engineering and design work. In the first half of 2020, the Company will continue to focus on detailed engineering and design work and early procurement initiatives under a Board-approved capital program of up to $53 million, to be funded from operating cash flow. The Company will also be reviewing financing options, with a specific focus on the availability of debt to finance the capital costs for the underground development which exceed the Company's cash flow from operations. An update to the market will be provided as progress is made.

**CLARA**

Following an inaugural diamond sale in December 2018 on the Clara platform, Lucara's 100% owned digital sales platform, the focus in 2019 was to increase the frequency of diamond sales and the number of customers regularly purchasing through the platform. As of December 31, 2019, the customer base had increased to 27 participants, with total sales volumes of $8.4 million from 15 sales on the platform, predominately from the sale of Karowe goods. Further growth is expected through 2020 as more supply is made available through the platform, balanced with demand from the customer base. Third-party supply will complement the diamonds from Karowe which are sold through the platform and will support increased transaction volumes through 2020. Between December 2018 and February 2020, Clara's customer base grew to 32 and total sales volumes of approximately $11.0 million had been transacted from 19 sales on the platform.

**LIQUIDITY AND CAPITAL RESOURCES**

As at December 31, 2019, the Company had cash and cash equivalents of $11.2 million. After adjustments for working capital items, cash flow from operations totalled $50.1 million, an 11% increase from the $45.1 million generated from operations in 2018. Spending during the year ended December 31, 2019 was focused on investments in the business including mineral property expenditures of $9.2 million (2018: $20.3 million) and the acquisition of plant and equipment assets of $17.6 million (2018: $17.1 million). Activities associated with capitalized production stripping of $21.4 million were completed in 2018. In addition, during 2019 the Company paid dividends of $22.4 million (2018: $30.3 million) and repaid $10.0 million to reduce its working capital facility to $nil as of December 31, 2019 (2018 - $10.0 million borrowed).

Working capital as at December 31, 2019 was $60.9 million as compared to $48.8 million as at December 31, 2018. The 25% increase in working capital reflects a rough inventory build of 33% due to a record year of ore tonnes processed in the plant and an increase in the stockpile balance from strong mining activities, as planned.

The Company had no debt outstanding at December 31, 2019 (2018 - $10.1 million outstanding). Amounts available under the credit facility were $50.0 million as of December 31, 2019. Long-term liabilities consist of restoration provisions of $23.6 million (2018: $20.2 million), deferred income taxes of $63.0 million (2018: $73.5 million), and other non-current liabilities of $0.8 million (2018: $nil) which consist of leases reclassified under *IFRS 16: Leases* as of January 1, 2019.

Total shareholders' equity decreased from $241.9 million as at December 31, 2018 to $236.9 million as at December 31, 2019, mainly due to increases in the deficit and accumulated other comprehensive loss. Other minor changes to share capital and contributed surplus were related to share units vesting and the recording of share-based compensation during the year.

Since the inception of a regular dividend payment in June 2014, a total of $271.1 million (C$348.8 million) has been returned to shareholders. In January 2019, the Board of Directors announced an annual dividend of C$0.10 per share, to be paid quarterly. Three of the four payments were made in 2019. However, in light of the positive feasibility study for development of an underground mine at Karowe and after careful consideration of the best use of the Company's available cash, the Board of Directors elected to suspend the quarterly dividend payment in Q4 2019.

## SUMMARY OF QUARTERLY RESULTS

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

**Table 4**: The following table provides highlights, extracted from the Company's consolidated financial statements, of quarterly results for the past eight quarters:

| Three months ended | Dec-19 | Sept-19 | Jun-19 | Mar-19 | Dec-18 | Sept-18 | Jun-18 | Mar-18 |
|---|---|---|---|---|---|---|---|---|
| A. Revenues | 55,993 | 45,317 | 42,541 | 48,690 | 40,609 | 45,669 | 64,539 | 25,374 |
| B. Administration expenses | (4,993) | (3,921) | (3,960) | (2,777) | (4,369) | (2,849) | (3,342) | (5,831) |
| C. Net income (loss) | 8,635 | (4,012) | 675 | 7,416 | (6,225) | 5,136 | 19,698 | (6,957) |
| D. Earnings (loss) per share (basic and diluted) | 0.02 | (0.01) | 0.00 | 0.02 | (0.02) | 0.01 | 0.05 | (0.02) |

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. Commencing in September 2018, the Company moved to a blended tender process to reduce the length of time that high value diamonds remained in inventory. This change has resulted in more consistent quarterly revenue when compared to previous quarters.

The quarter ended December 31, 2019 was representative of a stronger pricing environment coupled 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 the majority 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 Company's only Exceptional Stone Tender of 2018 occurred during the three months ended June 30, 2018 and contributed $32.5 million of the total revenues of $64.5 million recognized during the quarter.

Administration expense of $5.8 million during the quarter ended March 31, 2018 included the payment of severance.

## 2020 OUTLOOK

This section of the MD&A provides management's production and cost estimates for 2020. These are "forward-looking statements" and subject to the cautionary note regarding the risks associated with forward-looking statements. No changes have been made to our 2020 outlook previously provided.

***Karowe Mine, Botswana***

**Table 5: 2020 Diamond Sales, Production and Outlook**

| **Karowe Diamond Mine**<br><br>*In millions of U.S. dollars unless otherwise noted* | **Full Year – 2020** |
|---|---|
| Diamond revenue (millions) | $180 to $210 |
| Diamond sales (thousands of carats) | 350 to 390 |
| Diamonds recovered (thousands of carats) | 370 to 410 |
| Ore tonnes mined (millions) | 3.5 to 3.9 |
| Waste tonnes mined (millions) | 3.6 to 4.2 |
| Ore tonnes processed (millions) | 2.5 to 2.8 |
| Total operating cash costs(1) including waste mined(2) (per tonne processed) | $32.00 to $36.00 |
| Botswana general & administrative expenses including marketing costs (per tonne processed) | $3.00 to $4.00 |
| Tax rate | 22% |
| Average exchange rate – USD/Pula | 10.5 |

(1) Operating cash costs are a non-IFRS measure. See "Non-IFRS Measures" on page 10.
(2) Includes ore and waste mined cash costs of $4.40 to $4.90 (per tonne mined) and processing cash costs of $11.50 to $12.50 (per tonne processed).

In 2020, the Company forecasts revenues between $180 million and $210 million, as the proportion of carats recovered from the higher grade M/PK(S) and EM/PK(S) units increases. Diamond price assumptions are considered to be consistent with 2019. The Company expects to recover 350,000 to 390,000 carats from the processing of 2.5 to 2.8 million tonnes of ore. Diamonds sold are expected to be between 350,000 carats and 390,000 carats.

Following the completion of a significant waste stripping campaign between 2017 and early 2019, total tonnes mined in 2020 are expected to be between 7.1 million and 8.1 million tonnes, of which the Company expects to mine between 3.5 million to 3.9 million tonnes of ore and between 3.6 and 4.2 million tonnes of waste. The average strip ratio is expected to be approximately 1.0 in 2020.

The 2020 estimated cash cost per tonne of ore processed is expected to be between $32.00 and $36.00. The cost per tonne mined is expected to be between $4.40 and $4.90 and the estimated processing cost per tonne processed is expected to be between $11.50 and $12.50, a reflection of optimization work and strong operating performance in the plant.

A budget of up to $53 million has been approved for early works related to a proposed underground mine at Karowe. An investment decision, subject to receipt of all required authorizations and the arrangement of financing, is expected in H2 2020. Following the positive results of a feasibility study announced on November 4, 2019 and based on the Company's ability to fund these initial capital expenditures from operating cash flow, a program of early works, including detailed engineering and design work has been approved to mitigate key risks related to schedule.

Lucara Botswana's progressive tax rate computation allows for the immediate deduction of operating costs, including capital expenditures, in the year in which they are incurred. Based on 2020 revenue guidance of $180 million to $210 million the expected tax rate is 22% for 2020 but could decrease depending on the amount and timing of capital expenditures during the year.

Sustaining capital and project expenditures are expected to be up to $25.0 million in 2020, including expenditures associated with slimes dam wall raising (a multi-year project), upgrades to the XRT recovery circuit and a provision for the implementation of body scanning technology (to enhance security) which had originally been planned for 2019, subject to receipt of regulatory approval.

## NON-IFRS FINANCIAL MEASURES

This MD&A refers to certain financial measures, such as adjusted EBITDA, 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 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 December 31** | | **Year ended December 31** | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| Cash flows from operating activities | $ 19,103 | $ 8,699 | $ 50,092 | $45,112 |
| Changes in non-cash working capital | 1,677 | 2,251 | 10,670 | 11,257 |
| Total cash flow from operating activities before changes in non-cash working capital | 20,780 | 6,448 | 60,762 | 56,369 |
| Weighted average common shares outstanding | 396,858,168 | 396,509,386 | 396,790,950 | 394,008,955 |
| **Operating cash flow per share[(1)]** | **$0.05** | $0.02 | **$0.15** | $0.14 |

[(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 carats 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* | Year ended December 31, | |
|---|---|---|
| | **2019** | 2018[(1)] |
| Operating expenses | $ 77.7 | $ 75.7 |
| Capitalized production stripping costs[(2)] | - | 20.2 |
| Net change rough diamond inventory, excluding depletion and amortization [(3)] | 3.8 | 0.6 |
| Net change ore stockpile inventory, excluding depletion and amortization [(4)] | 7.9 | 8.4 |
| Total operating costs for ore processed | 89.4 | 104.9 |
| Tonnes processed | 2,804,517 | 2,629,048 |
| **Operating cost per tonne of ore processed**[(5)] | **$ 31.88** | $ 39.92 |

[(1)] Amended to be on a comparable presentation basis. Net change in rough diamond inventory was previously presented on a gross change basis. In 2019, the net change in rough diamond inventory is reported excluding the change in depletion and amortization, a non-cash item, to better present the operating cost per tonne of ore processed which is designed to be a cash measure.

[(2)] Capitalized production stripping cost in investing activities in the annual audited consolidated statements of cash flows.

[(3)] Net change in rough diamond inventory, excluding depletion and amortization.

[(4)] Net change in ore stockpile inventory, excluding depletion and amortization.

[(5)] 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 16 of the audited consolidated financial statements for the year ended December 31, 2019.

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 December 31, 2019, none of the revenue milestones had been achieved.

| Name | Position | Lucara shares issued as consideration for Clara in February 2018 | Lucara shares to be issued if Performance Milestones are achieved |
|---|---|---|---|
| Eira Thomas | President, CEO & Director (Founder of Clara) | 1,192,000 | 1,788,001 |
| Catherine McLeod-Seltzer | Director (Founder of Clara) | 400,000 | 600,000 |
| John Armstrong | VP, Technical Services | 50,000 | 74,999 |
| Zara Boldt | CFO & Corporate Secretary | 50,000 | 74,999 |

A profit sharing mechanism also exists, whereby a total of 3.45% of the EBITDA generated by the platform has been assigned to Ms. Thomas and Ms. McLeod-Seltzer as founders of the platform, with the remaining 3.22% of the EBITDA generated by the platform to be distributed to management, including Dr. Armstrong and Ms. Boldt, at the discretion of Lucara's compensation committee based on key performance targets. In March 2019, the EBITDA sharing agreement between Clara and Eira Thomas and Clara and the Clara Management was amended. Under the terms of the amendment, each of Eira Thomas and the Clara Management waived their respective rights to the EBITDA payment to the extent that such payment relates to net income earned by Clara on the sale of rough diamonds from Karowe Mine. This waiver is in effect from the date of the share purchase agreement in February 2018 through to December 31, 2020.

## FINANCIAL INSTRUMENTS

In the normal course of business, the Company is inherently exposed to currency and commodity price risk. For a discussion of certain risks and assumptions that relate commodity price risk, currency risk, liquidity risk and credit risk, refer to Note 18 in the Company's audited consolidated financial statements for the year ending December 31, 2019. Note 18 also includes a discussion of the methods used to value financial instruments, as well as any significant assumptions made as part of the valuation.

## OUTSTANDING SHARE DATA

As at the date of this MD&A, the Company had 396,858,168 common shares outstanding, 1,084,990 share units and 4,522,000 stock options outstanding under its stock-based incentive plans.

In February 2020, Lucara's Board of Directors adopted a deferred share unit plan (the "DSU Plan") pursuant to which deferred share units ("DSUs") may be granted to non-executive directors from time to time. The purpose of the DSU Plan is to promote a greater alignment of long-term interests between directors and shareholders of the Company and to provide a compensation system for non-executive directors that, together with the other compensation mechanisms of the Company, is reflective of the responsibility, commitment and risk accompanying Board membership and the performance of the duties required of the non-executive directors. The DSU Plan is subject to both shareholder and regulatory approval. Under the terms of the DSU Plan, DSUs may be granted from time to time as equity-based compensation for services provided by the non-executive directors. In addition, each non-executive director may elect to take his or her annual Board retainer in the form of DSUs, rather than in cash. The Board has discretion to impose vesting terms on those DSUs granted to non-executive directors as equity-based compensation. The DSUs can be settled in cash, common shares or a combination thereof within thirty days of the date which the individual ceases to be a Director of Lucara.

## 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 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.

## 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.

## ANNUAL MEETING INFORMATION

The Company's annual general meeting of shareholders will be held on May 8, 2020 in Toronto, Canada.

## CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The application of certain accounting policies requires the Company to make estimates that affect both the amount and timing of the recording of assets, liabilities, revenues and expenses. Some of these estimates require judgments about matters that are inherently uncertain.

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. The following policies are considered to be critical accounting policies since they involve the use of significant estimates.

### *Estimated Recoverable Reserves and Resources*

Mineral reserve and resource estimates are based on various assumptions relating to operating matters. These include production costs, mining and processing recoveries, cut-off grades, long term commodity prices and, in some cases, exchange rates, inflation rates and capital costs. Cost estimates are based on feasibility study estimates or operating history. Estimates are prepared by appropriately qualified persons, but will be affected by forecasted diamond prices, commodity prices, inflation rates, exchange rates, capital and production costs and recoveries amongst other factors.

Proven and probable reserves are determined based on a professional evaluation using accepted international standards for the assessment of mineral reserves. The assessment involves geological and geophysical studies and economic data and the reliance on a number of assumptions. The estimates of the reserves may change based on additional knowledge gained subsequent to the initial assessment. This may include additional data available from continuing exploration, results from the reconciliation of actual mining production data against the original reserve estimates, or the impact of economic factors such as changes in the price of commodities or the cost of components of production.

Estimated recoverable reserves and resources are used to determine the depletion and amortization of property, plant and equipment at the operating mine site, in accounting for deferred stripping costs and mineral properties, determining a deferred tax rate and in performing impairment testing. Therefore, changes in the assumptions used could affect the carrying value of assets, depletion and amortization and impairment charges recorded in the income statement.

### *Mineral Properties*

The Company carries its mineral properties at depleted cost less any provision for impairment. The costs of each property will be amortized over the economic life of the property on a unit of production basis. Costs are charged to operations when a property is abandoned or when impairment in value, other than temporary, has been determined. Exploration costs are charged to operations as incurred.

The Company undertakes a periodic review of the carrying values of mineral properties and whenever events or changes in circumstances indicate that their carrying value may exceed their fair value. In undertaking this review, management of the Company is required to make significant estimates. Following the release of a new Mineral Resource Estimate for Karowe in mid-2018, the remaining life-of-mine reserve base was adjusted, resulting in a higher depletion rate than in previous years. These estimates are subject to various risks and uncertainties, which may ultimately have an effect on the expected recoverability of the carrying values of the mineral properties and related expenditures.

### *Income Taxes*

The deferred tax provisions are calculated by the Company whilst the actual amounts of income tax expense are not final until tax returns are filed and accepted by the relevant authorities. Judgment is required in assessing whether deferred tax assets and certain deferred tax liabilities are recognized on the balance sheet and what tax rate is expected to be applied in the year when the related temporary differences reverse. Deferred tax liabilities arising from temporary differences are recognized unless the reversal of the temporary differences is not expected to occur in the foreseeable future and can be controlled. Assumptions about the generation of future taxable profits and repatriation of retained earnings depend on management's estimates of future production and sales volumes, diamond prices, reserves and resources, operating costs, decommissioning and restoration costs, capital expenditures, dividends and other capital management transactions. These estimates and judgments are subject to risk and uncertainty and could result in an adjustment to the deferred tax provision and a corresponding credit or charge to profit.

### *Decommissioning and Site Restoration*

The Company has obligations for site restoration and decommissioning related to the Karowe Diamond Mine. The future obligations for decommissioning and site restoration activities are estimated by the Company using mine closure plans or other similar studies which outline the requirements that will be carried out to meet the obligations. Because the obligations are dependent on the laws and regulations of Botswana, the requirements could change as a result of amendments in the laws and regulations relating to environmental protection and other legislation affecting resource companies. As the estimate of obligations is based on future expectations, a number of assumptions and judgments are made by management in the determination of closure provisions. The decommissioning and site restoration provisions are more uncertain the further into the future the mine closure activities are to be carried out.

The Company's policy for recording decommissioning and site restoration provisions is to establish provisions for future mine closure costs at the commencement of mining operations based on the present value of the future cash flows required to satisfy the obligations. The amount of the present value of the provision is added to the cost of the related mining assets and amortized over the life of the mine. The provision is accreted to its future value over the life of the mine through a charge to finance costs. Actual results could differ from estimates made by management during the preparation of these consolidated financial statements and those differences may be material.

## CHANGES IN ACCOUNTING POLICIES

As of January 1, 2019, the Company adopted a new accounting policy for leases – IFRS 16. A description of this accounting policy can be found in Note 3 of the audited consolidated financial statements for the year ended December 31, 2019.

## MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation of this document along with the audited 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 audited consolidated financial statements to ensure the reliability and timeliness of the Company's disclosure while providing another level of review for accuracy and oversight. The Board of Directors, based on recommendations from Lucara's Audit Committee, reviews and approves the financial information contained in the audited consolidated financial statements and the MD&A.

## INTERNAL FINANCIAL REPORTING AND DISCLOSURE CONTROLS

*Disclosure controls and procedures*

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. As of December 31, 2019, the Chief Executive Officer and Chief Financial Officer have each concluded that the Company's disclosure controls and procedures, as defined in NI 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to achieve the purpose for which they have been designed.

*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.

The Company's internal controls over financial reporting include policies and procedures that: pertain to the maintenance of records that, in reasonable detail accurately and fairly reflect the transactions and disposition of assets; provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with IFRS and that receipts and expenditures are being made only in accordance with authorization of management and directors of the Company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements.

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's internal controls over financial reporting. As of December 31, 2019, the Chief Executive Officer and Chief Financial Officer have each concluded that the Company's internal controls over financial reporting, as defined in NI 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to achieve the purpose for which they have been designed.

Because of their inherent limitations, internal controls over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

**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 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; start-up, exploration and development plans and objectives; production costs; exploration and development expenditures and reclamation costs; expectation of diamond price and changes to foreign currency exchange rates; assumptions and expectations related to the possible development of an underground mining operation at Karowe; 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 achieved margins in pricing, the timing and cost of commercialization and operation of the Clara platform, the timing and frequency of sales on the Clara Platform, and future participation of third parties on the Clara platform; expectations regarding the need to raise capital; 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 "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 by law.

# *Independent auditor's report*

To the Shareholders of Lucara Diamond Corp.

## *Our opinion*

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Lucara Diamond Corp. and its subsidiaries (together, the Company) as at December 31, 2019 and 2018, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

**What we have audited**

The Company's consolidated financial statements comprise:

- the consolidated balance sheets as at December 31, 2019 and 2018;
- the consolidated statements of operations for the years then ended;
- the consolidated statements of comprehensive income (loss) for the years then ended;
- the consolidated statements of cash flows for the years then ended;
- the consolidated statements of changes in equity for the years then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

## *Basis for opinion*

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Independence**

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

## *Other information*

Management is responsible for the other information. The other information comprises the Annual Management's Discussion and Analysis.

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*PricewaterhouseCoopers Place, 250 Howe Street, Suite 1400, Vancouver, British Columbia, Canada V6C 3S7*
*T: +1 604 806 7000, F: +1 604 806 7806*

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## *Responsibilities of management and those charged with governance for the consolidated financial statements*

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

## *Auditor's responsibilities for the audit of the consolidated financial statements*

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Mark Platt.

**(Signed) "PricewaterhouseCoopers LLP"**

Chartered Professional Accountants

Vancouver, British Columbia
February 23, 2020

## LUCARA DIAMOND CORP.
**CONSOLIDATED BALANCE SHEETS**
**(In thousands of U.S. Dollars)**

| | | December 31, 2019 | | December 31, 2018 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Current assets | | | | |
| Cash and cash equivalents | $ | 11,197 | $ | 24,355 |
| VAT receivables and other (Note 5) | | 6,248 | | 11,583 |
| Inventories (Note 6) | | 65,052 | | 48,146 |
| | | 82,497 | | 84,084 |
| Investments | | 241 | | 920 |
| Plant and equipment (Note 7) | | 130,108 | | 147,246 |
| Mineral properties (Note 8) | | 105,243 | | 113,109 |
| Intangible assets (Note 9) | | 22,774 | | 21,798 |
| Other non-current assets | | 5,168 | | 3,738 |
| **TOTAL ASSETS** | $ | 346,031 | $ | 370,895 |
| **LIABILITIES** | | | | |
| Current liabilities | | | | |
| Trade payables and accrued liabilities | $ | 15,880 | $ | 21,204 |
| Credit facility (Note 18) | | - | | 10,111 |
| Taxes payable | | 4,397 | | 3,999 |
| Lease liabilities | | 1,347 | | - |
| | | 21,624 | | 35,314 |
| Restoration provisions (Note 10) | | 23,629 | | 20,184 |
| Deferred income taxes (Note 14) | | 63,015 | | 73,482 |
| Lease liabilities | | 828 | | - |
| **TOTAL LIABILITIES** | | 109,096 | | 128,980 |
| **EQUITY** | | | | |
| Share capital (unlimited common shares, no par value) | | 314,820 | | 313,913 |
| Contributed surplus | | 7,679 | | 7,766 |
| Deficit | | (31,494) | | (21,767) |
| Accumulated other comprehensive loss | | (54,070) | | (57,997) |
| **TOTAL EQUITY** | | 236,935 | | 241,915 |
| **TOTAL LIABILITIES AND EQUITY** | $ | 346,031 | $ | 370,895 |

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

Approved on Behalf of the Board of Directors:

“Marie Inkster”
Director

“Brian Edgar”
Director

# LUCARA DIAMOND CORP.
**CONSOLIDATED STATEMENTS OF OPERATIONS**
**FOR THE YEARS ENDED DECEMBER 31**
**(In thousands of U.S. Dollars, except for share and per share amounts)**

| | | 2019 | | 2018 |
|---|---|---|---|---|
| **Revenues** | $ | 192,541 | $ | 176,191 |
| **Cost of goods sold** | | | | |
| Operating expenses | | 77,697 | | 75,731 |
| Royalty expenses (Note 8) | | 19,194 | | 17,619 |
| Depletion and amortization | | 51,267 | | 31,405 |
| | | 148,158 | | 124,755 |
| **Income from mining operations** | | 44,383 | | 51,436 |
| **Other expenses** | | | | |
| Administration (Note 13) | | 15,651 | | 16,391 |
| Exploration expenditures | | 4,572 | | 3,359 |
| Finance expenses | | 3,118 | | 2,552 |
| Foreign exchange loss | | 2,634 | | 2,338 |
| Sales and marketing | | 2,246 | | 2,599 |
| | | 28,221 | | 27,239 |
| **Net income before tax** | | 16,162 | | 24,197 |
| **Income tax expense (recovery)** (Note 14) | | | | |
| Current income tax expense | | 14,470 | | 5,857 |
| Deferred income tax expense (recovery) | | (11,022) | | 6,688 |
| | | 3,448 | | 12,545 |
| **Net income for the year** | $ | 12,714 | $ | 11,652 |
| **Earnings per common share** (Note 15) | | | | |
| Basic | $ | 0.03 | $ | 0.03 |
| Diluted | $ | 0.03 | $ | 0.03 |
| **Weighted average common shares outstanding** (Note 15) | | | | |
| Basic | | 396,790,950 | | 394,008,955 |
| Diluted | | 397,912,814 | | 395,513,705 |

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

# LUCARA DIAMOND CORP.
## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
## FOR THE YEARS ENDED DECEMBER 31
## (In thousands of U.S. Dollars)

| | | 2019 | | 2018 |
|---|---|---|---|---|
| **Net income for the year** | $ | 12,714 | $ | 11,652 |
| **Other comprehensive income (loss)** | | | | |
| **Items that will not be reclassified to net income** | | | | |
| Change in fair value of marketable securities | | (679) | | (1,187) |
| **Items that may be subsequently reclassified to net income** | | | | |
| Currency translation adjustment | | 4,606 | | (17,851) |
| | | 3,927 | | (19,038) |
| **Comprehensive income (loss)** | $ | 16,641 | $ | (7,386) |

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

# LUCARA DIAMOND CORP.
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**FOR THE YEARS ENDED DECEMBER 31**
**(In thousands of U.S. Dollars)**

| | 2019 | 2018 |
|---|---|---|
| **Cash flows from (used in):** | | |
| **Operating activities** | | |
| Net income for the year | $ 12,714 | $ 11,652 |
| Items not involving cash and cash equivalents: | | |
| Depletion and amortization | 52,946 | 31,741 |
| Unrealized foreign exchange loss | 2,634 | 2,338 |
| Share-based compensation | 1,186 | 1,447 |
| Deferred income taxes | (11,022) | 6,688 |
| Finance costs | 2,304 | 2,503 |
| | 60,762 | 56,369 |
| Net changes in working capital items: | | |
| VAT receivables and other | 5,538 | (8,162) |
| Inventories | (12,523) | (13,090) |
| Trade payables and other current liabilities | (4,041) | 6,258 |
| Taxes payable | 356 | 3,737 |
| | 50,092 | 45,112 |
| **Financing activities** | | |
| Dividends paid | (22,380) | (30,274) |
| Proceeds (repayments) of credit facility, net | (10,000) | 10,000 |
| Proceeds from exercise of stock options | - | 327 |
| Withholding tax for share units vested | (427) | (364) |
| Interest paid | (107) | - |
| Principal elements of lease payments | (1,421) | - |
| | (34,335) | (20,311) |
| **Investing activities** | | |
| Acquisition and disposition of plant and equipment, net | (17,563) | (17,146) |
| Capitalized mineral property expenditure | (9,178) | (20,266) |
| Capitalized production stripping costs | - | (21,425) |
| Acquisition and development of intangible assets | (404) | (1,800) |
| Acquisition of other assets | (1,882) | (81) |
| | (29,027) | (60,718) |
| **Effect of exchange rate change on cash and cash equivalents** | 112 | (793) |
| **Decrease in cash and cash equivalents during the year** | (13,158) | (36,710) |
| **Cash and cash equivalents, beginning of year** | 24,355 | 61,065 |
| **Cash and cash equivalents, end of year**[(1)] | $ 11,197 | $ 24,355 |
| **Supplemental information** | | |
| Interest received | 236 | 95 |
| Taxes paid | (9,751) | (5,429) |
| Changes in trade payables and accrued liabilities related to plant and equipment | 1,386 | 198 |

(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 consolidated financial statements.

## LUCARA DIAMOND CORP.
**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**
**FOR THE YEARS ENDED DECEMBER 31**
**(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated)**

| | Number of shares issued and outstanding | | Share capital | | Contributed surplus | | Retained earnings (deficit) | | Accumulated other comprehensive loss | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance, January 1, 2018** | 382,619,334 | $ | 290,846 | $ | 7,832 | $ | (3,043) | $ | (38,959) | $ | 256,676 |
| Exercise of stock options | 200,000 | | 441 | | (114) | | - | | - | | 327 |
| Share-based compensation | - | | - | | 1,447 | | - | | - | | 1,447 |
| Effect of foreign currency translation | - | | - | | - | | - | | (17,851) | | (17,851) |
| Change in fair value through other comprehensive income securities | - | | - | | - | | - | | (1,187) | | (1,187) |
| Shares issued for Clara acquisition (Note 9) | 13,100,000 | | 21,489 | | - | | - | | - | | 21,489 |
| Shares issued from SUs vested | 590,053 | | 1,137 | | (1,137) | | - | | - | | - |
| Withholding tax for SUs vested | - | | - | | (364) | | - | | - | | (364) |
| Dividends paid[(1)] | - | | - | | 102 | | (30,376) | | - | | (30,274) |
| Net income for the year | - | | - | | - | | 11,652 | | - | | 11,652 |
| **Balance, December 31, 2018** | 396,509,387 | $ | 313,913 | $ | 7,766 | $ | (21,767) | $ | (57,997) | $ | 241,915 |
| **Balance, January 1, 2019** | 396,509,387 | $ | 313,913 | $ | 7,766 | $ | (21,767) | $ | (57,997) | $ | 241,915 |
| Share-based compensation | - | | - | | 1,186 | | - | | - | | 1,186 |
| Effect of foreign currency translation | - | | - | | - | | - | | 4,606 | | 4,606 |
| Change in fair value through other comprehensive income securities | - | | - | | - | | - | | (679) | | (679) |
| Shares issued from SUs vested | 348,781 | | 907 | | (907) | | - | | - | | - |
| Withholding tax for SUs vested | - | | - | | (427) | | - | | - | | (427) |
| Dividends paid[(2)] | - | | - | | 61 | | (22,441) | | - | | (22,380) |
| Net income for the year | - | | - | | - | | 12,714 | | - | | 12,714 |
| **Balance, December 31, 2019** | 396,858,168 | $ | 314,820 | $ | 7,679 | $ | (31,494) | $ | (54,070) | $ | 236,935 |

(1) On April 12, June 21, September 20, and December 20, 2018 the Company paid a cash dividend of CA$0.025 per share.
(2) On April 11, June 20, and September 19, 2019 the Company paid a cash dividend of CA$0.025 per share.

The accompanying notes are an integral part of these 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 2000 - 885 West Georgia Street, Vancouver, British Columbia, V6C 3E8.

## 2. BASIS OF PRESENTATION

The Company prepares its financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The same accounting policies have been consistently applied in all periods presented, other than the adoption of IFRS 16, Leases.

These financial statements were approved by the Board of Directors for issue on February 23, 2020.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used in the preparation of these consolidated financial statements are as follows:

*(a) Basis of measurement*

These consolidated financial statements have been prepared under the historical cost convention, except for investments in equity securities, which are measured at fair value.

*(b) Consolidation*

These consolidated financial statements include the accounts of the Company and all of its subsidiaries (see Note 12 Principal subsidiaries).

Subsidiaries are entities controlled by the Company. An entity is controlled by the Company when as a group; it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are included in the consolidated financial statements from the date control is obtained until the date control ceases. Where the Company's interest is less than 100%, the Company recognizes non-controlling interests. All intercompany balances, transactions, income, expenses, profits and losses, including unrealized gains and losses have been eliminated on consolidation.

*(c) Critical accounting estimates and judgments*

The preparation of consolidated financial statements requires management to use judgment in applying its accounting policies and estimates and assumptions about the future. Estimates and other judgments are continuously evaluated and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. The following discusses the most significant accounting judgments and estimates that the Company has made in the preparation of the consolidated financial statements:

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

*Estimated recoverable reserves and resources* – Mineral reserve and resource estimates are based on various assumptions relating to operating matters. These include production costs, mining and processing recoveries, cut-off grades, long term diamond prices and, in some cases, exchange rates, inflation rates and capital costs. Cost estimates are based on feasibility study estimates or operating history. Estimates are prepared by appropriately qualified persons, but will be affected by forecasted commodity prices, diamond prices, inflation rates, exchange rates, capital and production costs and recoveries amongst other factors. Estimated recoverable reserves and resources are used to determine the depletion and amortization of property, plant and equipment at the operating mine site, in accounting for deferred stripping costs and mineral properties, determining a deferred tax rate and in performing impairment testing. Therefore, changes in the assumptions used could affect the carrying value of assets, depletion and amortization, changes in the deferred tax rate, and impairment charges recorded in the income statement.

*Valuation of mineral properties* – The Company carries its mineral properties at depleted cost less any provision for impairment. The Company undertakes a periodic review of the carrying values of mineral properties as well as whenever events or changes in circumstances indicate that their carrying values may exceed their fair value. In undertaking this review, management of the Company is required to make significant estimates. These estimates are subject to various risks and uncertainties, which may ultimately have an effect on the expected recoverability of the carrying values of the mineral properties and related expenditures.

*Deferred Taxes* - The deferred tax provisions are calculated by the Company whilst the actual amounts of income tax expense are not final until tax returns are filed and accepted by the relevant authorities. Judgment is required in assessing whether deferred tax assets and certain deferred tax liabilities are recognized on the balance sheet and what tax rate is expected to be applied in the year when the related temporary differences reverse. Deferred tax liabilities arising from temporary differences are recognized unless the reversal of the temporary differences is not expected to occur in the foreseeable future and can be controlled. Assumptions about the generation of future taxable profits and repatriation of retained earnings depend on management's estimates of future production and sales volumes, diamond prices, reserves and resources, operating costs, decommissioning and restoration costs, capital expenditures, dividends and other capital management transactions. These estimates and judgments are subject to risk and uncertainty and could result in an adjustment to the deferred tax provision and a corresponding credit or charge to profit.

*Decommissioning and site restoration* – The Company has obligations for site restoration and decommissioning related to the Karowe Diamond Mine. The future obligations for decommissioning and site restoration activities are estimated by the Company using mine closure plans or other similar studies which outline the requirements that will be carried out to meet the obligations. Because the obligations are dependent on the laws and regulations of the country in which the mine operates, the requirements could change as a result of amendments in the laws and regulations relating to environmental protection and other legislation affecting resource companies. As the estimate of obligations is based on future expectations, a number of assumptions and judgments are made by management in the determination of closure provisions. The decommissioning and site restoration provisions are more uncertain the further into the future the mine closure activities are to be carried out.

The Company's policy for recording decommissioning and site restoration provisions is to establish provisions for future mine closure costs at the commencement of mining operations based on the present value of the future cash flows required to satisfy the obligations. The amount of the present value of the provision is added to the cost of the related mining assets and depreciated over the life of the mine. The provision is accreted to its future value over the life of the mine through a charge to finance costs. Actual results could differ from estimates made by management during the preparation of these consolidated financial statements.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

*(d) Segment reporting*

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the person that makes strategic decisions. The CEO is deemed the chief operating decision-maker of the Company.

The Company's primary reporting segments are based on individual operating segments, being the Karowe Mine and Corporate and other. The Corporate office provides support to the Karowe Mine with respect to sales, treasury and finance, technical support, regulatory reporting and corporate administration and includes operations of the secure, digital diamond sales platform, Clara.

*(e) Foreign currency translation*

*Functional and presentation currency*

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in U.S. dollars. The functional currency of the parent company, Lucara Diamond Corp., is the Canadian dollar.

*Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at exchange rates of monetary assets and liabilities denominated in currencies other than an entity's functional currency are recognized in the statement of operations.

*Group companies*

The functional currency of the most significant subsidiary of the Company, Lucara Botswana (Pty) Ltd., is the Botswana Pula. The functional currency of the Company and its other active subsidiary, Clara Diamond Solutions Limited Partnership., is the Canadian dollar. The results and financial position of the group companies, which have a functional currency different from the presentation currency, are translated into the presentation currency as follows:

(i) Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet

(ii) Income and expenses are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions).

(iii) All resulting exchange differences are recognized in other comprehensive income as cumulative translation adjustments.

*(f) Cash and cash equivalents*

Cash and cash equivalents include cash on account, demand deposits and money market investments with maturities from the date of acquisition of three months or less, which are readily convertible to known amounts of cash and are subject to insignificant changes in value. Cash and cash equivalents are recorded at fair value and subsequently measured at amortized cost.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

*(g) Financial instruments*

The Company has applied IFRS 9 Financial Instruments effective January 1, 2018. The transition provisions of IFRS 9 allow an entity not to restate comparatives. There were no financial assets or financial liabilities previously designated as at fair value through profit or loss under IAS 39 that were subject to reclassification or which the Company has elected to reclassify upon the application of IFRS 9. There were also no financial assets or financial liabilities which the Company has elected to designate as at fair value through profit and loss at the date of initial application of IFRS 9.

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires. All recognized financial assets are measured subsequently at amortized cost or fair value through profit or loss or fair value through other comprehensive income.

At initial recognition, the Company classifies its financial instruments in the following categories:

(i) Fair value through profit or loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges. Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated statement of operations. Gains and losses arising from changes in fair value are presented in the consolidated statement of operations within “other gains and losses” in the period in which they arise.

(ii) *Fair value through other comprehensive income*: The Company has made an irrevocable election to designate its investments in marketable equity securities as classified at fair value through other comprehensive income. Investment transactions are recognized on the trade date with transaction costs included in the underlying balance. Fair values are determined by reference to quoted market prices at the balance sheet date. When investments in marketable equity securities are disposed of or impaired, the cumulative gains and losses recognized in other comprehensive income are not recycled to profit and loss and remain within equity.

(iii) *Financial assets and liabilities at amortized cost*: Financial assets and liabilities at amortized cost include cash, trade receivables, credit facility and trade payables and are included in current classification due to their short-term nature. Trade receivables and payables are non-interest bearing if paid when due and are recognized at their face amount, less, when material, a discount, except when fair value is materially different. Amounts drawn on the credit facility are interest-bearing and are recorded at fair value upon inception. These are subsequently measured at amortized cost.

*(h) Inventories*

Inventories, which include rough diamonds, ore stockpiles and parts and supplies, are measured at the lower of cost and net realizable value. The amount of any write-down of inventories to net realizable value is recognized in the period the write-down occurs. Cost is determined using the weighted average method. Cost includes directly attributable mining overhead but excludes borrowing costs.

Net realizable value represents the estimated selling price in the ordinary course of business, less all estimated costs to completion and selling expenses.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

*(i) Plant and equipment*

Plant and equipment are stated at cost less accumulated amortization and impairment losses. The cost of an asset consists of its purchase price, any directly attributable costs of bringing the asset to its present working condition and location for its intended use and an initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably.

Amortization of each asset is calculated using the straight line or unit of production method to allocate its cost less its residual value over its estimated useful life. The estimated useful lives of plant and equipment are as follows:

| | |
|---|---|
| Machinery | 5 to 10 years |
| Mineral property & plant facilities | based on recoverable reserves on a unit of production basis |
| Furniture and office equipment | 2 to 3 years |

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized within "other gains and losses" in the statement of operations.

*(j) Exploration and evaluation expenditures*

Exploration and evaluation expenditures relate to the search for mineral resources, the determination of technical feasibility and the assessment of commercial viability of an identified resource. Exploration and evaluation activities include:

- Researching and analyzing historical exploration data;
- Gathering exploration data through topographical, geochemical and geophysical studies;
- Exploratory drilling, trenching and sampling;
- Determining and examining the volume and grade of the resource; and
- Surveying, transportation and infrastructure requirements.

Exploration and evaluation expenditures are expensed as incurred on mineral properties not sufficiently advanced as to identify their development potential.

*(k) Mineral properties*

Costs associated with acquiring a mineral property are capitalized as incurred. When it has been established that a mineral property is considered to be sufficiently advanced and an economic analysis has been completed, all further expenditures for the current year and subsequent years are capitalized as incurred. Mineral property costs are amortized from the date of commencement of commercial production of the related mine on a units of production basis.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

*(l) Capitalized production stripping costs*

During the production phase, mining expenditures (exploration or development costs) incurred either to develop new ore bodies or to develop mine areas in advance of current production are capitalized to mineral properties. Stripping costs incurred in the production phase are accounted for as variable production costs. However, stripping costs are capitalized and recorded on the statement of financial position as deferred stripping, a component of mineral properties, when the stripping activity provides access to sources of reserves or resources that will be produced in future periods that would not have otherwise been accessible in the absence of this activity. The deferred stripping costs are depleted on a unit-of-production basis over the reserves or resources that directly benefited from the stripping activity.

*(m) Intangible assets*

Intangible assets with finite lives consist of acquired trademarks, copyrights, patents and intellectual property that are initially capitalized at the purchase price plus any other directly attributable costs. These assets are amortized using the straight-line method over their estimated useful lives. Amortization of intangible assets will be included in the cost of sales, administrative expenses and/or research and development expenses, as appropriate.

Development expenditures relating to intangible assets are capitalized only if the expenditure can be measured reliably, the process is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development and to use or sell the asset. Judgment is required in determining the technical and commercial feasibility and in assessing the probability of future economic benefits. Amortization related to capitalized development costs is classified within depletion and amortization under operating expenses.

*(n) Contingent consideration*

Contingent consideration relating to an asset acquisition is recognized using the cost accumulation method when: (a) the conditions associated with the contingent payment are met; (b) the Company has a present legal or constructive obligation that can be estimated reliably; and (c) it is probable that an outflow of economic benefits will be required to settle the obligation.

*(o) Impairment of non-financial assets*

Long lived assets are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. Intangible assets that are not yet available for use are reviewed for impairment annually. An impairment loss is recognized for the amount by which the asset’s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset’s fair value less costs to sell and its value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

*(p) Provisions*

*Asset retirement obligations*

The Company recognizes a liability for an asset retirement obligation on long-lived assets when a present legal or constructive obligation exists, as a result of past events and the amount of the liability is reasonably determinable. Asset retirement obligations are initially recognized and recorded as a liability based on estimated future cash flows discounted at a risk free rate. This is adjusted at each reporting period for changes to factors including the expected amount of cash flows required to discharge the liability, the timing of such cash flows and the risk free discount rate. Corresponding amounts and adjustments are added to the carrying value of the related long-lived asset and amortized or depleted to operations over the life of the related asset.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

*Other provisions*

Provisions are recognized when:

- the Company has a present legal or constructive obligation as a result of a past event;
- a reliable estimate can be made of the obligation.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation, using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognized as finance costs.

*(q) Income taxes*

Income taxes are recognized in the statement of operations, except where they relate to items recognized in other comprehensive income or directly in equity, in which case the related taxes are recognized in other comprehensive income or equity.

Current taxes receivable or payable are based on estimated taxable income for the current year at the statutory tax rates enacted or substantively enacted less amounts paid or received on account.

Deferred taxes are recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable income, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future.

In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the sliding tax rate that is expected at the time of reversal and the laws that have been enacted or substantively enacted by the year end.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities where there is a legal right to do so, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future tax profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each year end and are reduced to extent that is no longer probable that the related tax benefit will be realized.

Uncertain tax positions and interest and penalties related to uncertain tax positions are accounted for under IFRIC 23, Uncertainty over Income Tax Treatments. The Company first determines whether it is more likely than not that a tax position will be sustained upon examination. If a tax position meets the more-likely-than-not recognition threshold it is then measured to determine the amount of benefit or liability to recognize in the financial statements. The tax position is measured as the amount of benefit or liability that is likely to be realized upon ultimate settlement. The Company assesses the validity of conclusions regarding uncertain tax positions on a quarterly basis to determine if facts or circumstances have arisen that might cause the Company to change their judgment regarding the likelihood of a tax position.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

*(r) Share capital*

Common shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

*(s) Revenue recognition*

Revenues from diamond sales are recognized when the purchaser obtains control of the diamond. Control is achieved when proceeds are received and title is transferred to the purchaser according to contract terms. IFRS 15 was adopted effective January 1, 2018 and had no material impact on the Company.

*(t) Share-based compensation*

The Company has a share-based compensation plan, under which the entity receives services from employees and non-employees as consideration for equity instruments (options) of the Company.

Stock options and share units granted to employees are measured on the grant date. Stock options granted to non-employees are measured on the date that the goods or services are received.

The fair value of the employee and non-employee services received in exchange for the grant of the options is recognized as an expense. The total amount to be expensed is determined by reference to the fair value of the stock options and share units granted and the vesting periods. The total expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied.

The cash subscribed for the shares issued when the options are exercised is credited to share capital, net of any directly attributable transaction costs.

*(u) Earnings (loss) per share*

Income (loss) per share is calculated by dividing the income or loss attributable to the shareholders of the Company by the weighted average number of common shares issued and outstanding during the year. Diluted income per share is calculated using the treasury stock method.

*(v) Leases - 2018*

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of operations on a straight-line basis over the period of the lease.

*(w) Leases - 2019*

The Company adopted IFRS 16, Leases on January 1, 2019 utilizing the modified retrospective approach. Comparatives were not restated. The Company utilized the following practical expedients in its adoption of IFRS 16: applying a single discount rate to similar leases of 5.2%, accounting for leases for which the term ends within 12 months or fewer of the date of initial application as short-term leases; and using hindsight in applying the new standard.

Leases are recognized as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use. Assets and liabilities arising from a lease are initially measured on a present value basis. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

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

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

The Company leases various properties. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants, but leased assets may not be used as security for borrowing purposes.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less.

*(x) Borrowing costs*

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalized as part of the cost of that asset. Other borrowing costs not directly attributable to a qualifying asset are expensed in the period incurred.

## 4. ADOPTION OF IFRS PRONOUNCEMENTS

IFRS pronouncements that have been issued but are not yet effective are listed below.

IFRS 3 – Business Combinations

As part of the annual improvements released in October 2018, amendments to the definition of a business under IFRS 3 were released to clarify and narrow the definition of a business and provide guidance and illustrative examples to assist in the application of the defined term in a business combination. The amendments are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2020 and to asset acquisitions that occur on or after the beginning of that period. While the standard has no impact to the Company on its adoption of January 1, 2020, future acquisitions under the revised definition may be viewed differently by the Company.

## 5. VAT RECEIVABLES AND OTHER

| | | **2019** | | 2018 |
|---|---|---|---|---|
| VAT | $ | 3,932 | $ | 8,967 |
| Other | | 208 | | 652 |
| Prepayments | | 2,108 | | 1,964 |
| | **$** | **6,248** | $ | 11,583 |

## 6. INVENTORIES

| | | **2019** | | 2018 |
|---|---|---|---|---|
| Rough diamonds | $ | 24,536 | $ | 16,847 |
| Ore stockpile | | 28,354 | | 20,435 |
| Parts and supplies | | 12,162 | | 10,864 |
| | **$** | **65,052** | $ | 48,146 |

Inventory expensed during the year ended December 31, 2019 totaled $77.7 million (2018 – $75.7 million). There were no inventory write-downs during the years ended December 31, 2019 and 2018.

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

## 7. PLANT AND EQUIPMENT

| Cost | Construction in progress | Mine and plant facilities | Vehicles | Furniture and office equipment | Leased assets | Total |
|---|---|---|---|---|---|---|
| **Balance, January 1, 2018** | $ 8,560 | $ 208,149 | $ 1,918 | $ 5,797 | $ - | $ 224,424 |
| Additions | 17,438 | - | - | 10 | - | 17,448 |
| Reclassification[1] | (19,756) | 16,131 | 804 | 1,520 | - | (1,301) |
| Disposals and other | - | - | - | (47) | - | (47) |
| Translation differences | (581) | (17,856) | (198) | (551) | - | (19,186) |
| **Balance, December 31, 2018** | $ 5,661 | $ 206,424 | $ 2,524 | $ 6,729 | $ - | $ 221,338 |
| IFRS 16 adoption | - | - | - | - | 3,691 | 3,691 |
| Additions[2] | 15,936 | 226 | - | 17 | - | 16,179 |
| Reclassification[3] | (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** |
| **Accumulated amortization** | | | | | | |
| **Balance, January 1, 2018** | $ - | $ 52,304 | $ 1,300 | $ 3,244 | $ - | $ 56,848 |
| Depletion and amortization | - | 21,595 | 320 | 1,167 | - | 23,082 |
| Disposals and other | - | - | - | (2) | - | (2) |
| Translation differences | - | (5,388) | (123) | (325) | - | (5,836) |
| **Balance, December 31, 2018** | $ - | $ 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** |
| **Net book value** | | | | | | |
| **As at December 31, 2018** | $ 5,661 | $ 137,913 | $ 1,027 | $ 2,645 | $ - | $ 147,246 |
| **As at December 31, 2019** | **$ 11,388** | **$ 112,225** | **$ 783** | **$ 3,573** | **$ 2,139** | **$ 130,108** |

(1) Karowe mine related expenditure of $599 was reclassified to mineral properties and $702 was reclassified to inventory (parts and supplies) in 2018.
(2) Additions include $3,691 recorded to leased assets upon the adoption of IFRS 16, Leases on January 1, 2019.
(3) 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)**

## 8. MINERAL PROPERTIES

| Cost | Capitalized production stripping asset | Karowe Mine | Total |
|---|---|---|---|
| **Balance, January 1, 2018** | $ 56,668 | $ 57,609 | $ 114,277 |
| Additions | 21,425 | 20,990 | 42,415 |
| Reclassification[1] | - | 599 | 599 |
| Translation differences | (5,741) | (5,826) | (11,567) |
| **Balance, December 31, 2018** | $ 72,352 | $ 73,372 | $ 145,724 |
| Additions | - | 10,320 | 10,320 |
| Reclassification[2] | - | 174 | 174 |
| Translation differences | 676 | 811 | 1,487 |
| **Balance, December 31, 2019** | **$ 73,028** | **$ 84,677** | **$ 157,705** |
| **Accumulated depletion** | | | |
| **Balance, January 1, 2018** | $ 5,431 | $ 18,287 | $ 23,718 |
| Depletion | 6,955 | 4,471 | 11,426 |
| Translation differences | (802) | (1,727) | (2,529) |
| **Balance, December 31, 2018** | $ 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** |
| **Net book value** | | | |
| **As at December 31, 2018** | $ 60,768 | $ 52,341 | $ 113,109 |
| **As at December 31, 2019** | **$ 48,603** | **$ 56,640** | **$ 105,243** |

(1) Karowe mine related expenditure of $599 was reclassified from plant and equipment to mineral properties in 2018.
(2) 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 year, the Company incurred a royalty expense of $19.2 million (2018: $17.6 million).

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

## 9. INTANGIBLE ASSETS

| | | |
|---|---|---|
| **Cost** | $ | - |
| Acquisition of intangible assets | | 21,868 |
| Development expenditures | | 1,139 |
| Translation differences | | (1,209) |
| **Cost, December 31, 2018** | | 21,798 |
| Development expenditures | | 404 |
| Translation differences | | 1,001 |
| **Cost, December 31, 2019** | **$** | **23,203** |
| Accumulated Depletion | | (429) |
| **Net book value, December 31, 2019** | **$** | **22,774** |

On March 2, 2018, the Company completed the acquisition of 100% of the issued and outstanding common shares of Clara Diamond Solutions Corporation, which subsequently became Clara Diamond Solutions Limited Partnership ("Clara"), a company whose primary asset is a secure, digital sales platform for rough diamonds. The total initial purchase consideration was $21.5 million, based on the closing price of the Company's common shares on the acquisition date, plus transaction costs and other adjustments of $0.4 million. The consideration paid was allocated entirely to the intangible assets.

The purchase consideration was as follows:

- 13.1 million Lucara shares.
- Contingent consideration of profit sharing: cash payments based on 3.45% of the annual EBITDA generated by the sales platform. Lucara also assumed the existing 13.3% annual EBITDA performance based contingent payments within Clara payable to the founders of the technology. This totals to 16.75% of the annual EBITDA generated by the sales platform, to a maximum of $20.9 million per year, for 10 years.
- Contingent consideration of share payments: additional Lucara shares to be issued if the revenue triggers detailed below are reached. In total, a maximum of 13.4 million shares may become issuable upon the achievement of the performance milestones related to revenue generated from the digital sales platform.

| Revenue Trigger | Number of shares | Expiry date |
|---|---|---|
| $200 million of cumulative revenue generated by the sales platform up to the expiry date | 3.0 million | March 2, 2028 |
| $400 million of cumulative revenue generated by the sales platform up to the expiry date | 3.0 million | March 2, 2030 |
| $800 million of cumulative revenue generated by the sales platform up to the expiry date | 3.2 million | March 2, 2032 |
| $1.6 billion of cumulative revenue generated by the sales platform up to the expiry date | 4.2 million | March 2, 2034 |

The contingent considerations will be recognized as additional purchase consideration for the intangible asset, if and when the obliging events occur.

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

As of September 1, 2019, management has determined that the sales platform is 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.

## 10. RESTORATION PROVISIONS

The Company's restoration provisions relate to the rehabilitation of the Karowe Diamond Mine in Bostwana. The provisions have been calculated based on total estimated rehabilitation costs and discounted back to their present values. The pre-tax discount rates and inflation rates are adjusted annually and reflect current market assessments. The Company has applied a pre-tax discount rate of 8.9% at December 31, 2019 (2018 - 10.4%) and an inflation rate of 4.0% at December 31, 2019 (2018 - 3.95%). Rehabilitation costs at the Karowe Diamond Mine are expected to commence during 2023 (the end of the current mining license for the open-pit) and continue through 2024. The estimated liability for reclamation and remediation costs on an undiscounted basis is approximately $27.1 million (2018 - $25.7 million).

| | | 2019 | | 2018 |
|---|---|---|---|---|
| **Balance, beginning of year** | $ | 20,184 | $ | 18,941 |
| Changes in rates and estimates | | 1,142 | | 724 |
| Accretion of liability component of obligation | | 2,200 | | 2,220 |
| Foreign currency translation adjustment | | 103 | | (1,701) |
| **Long-term portion of restoration provisions** | **$** | **23,629** | $ | 20,184 |

## 11. 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. 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.

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 December 31, 2017** | 3,738,337 | $ | 2.48 |
| Granted | 1,490,000 | | 2.36 |
| Exercised[1] | (200,000) | | 2.15 |
| Forfeited | (750,001) | | 2.79 |
| **Balance at December 31, 2018** | 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** |

(1) The weighted average share price on the exercise dates for the 2018 stock option exercises was CA$2.18.

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

## 11. SHARE BASED COMPENSATION (continued)

Options to acquire common shares have been granted and are outstanding at December 31, 2019 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$) | Number of options exercisable | Weighted average remaining contractual life (years) | Weighted average exercise price (CA$) |
| $1.50 - $2.00 | 1,437,000 | 3.16 | 1.64 | - | - | - |
| $2.01 - $2.50 | 2,700,000 | 1.13 | 2.39 | 1,886,667 | 0.62 | 2.42 |
| $2.51 - $3.00 | 385,000 | 1.25 | 2.76 | 256,667 | 1.25 | 2.76 |
| | **4,522,000** | **1.78** | **$ 2.19** | **2,143,334** | **0.69** | **$ 2.46** |

During the year ended December 31, 2019, an amount of $0.4 million (2018 – $0.5 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:

| | **2019** | **2018** |
|---|---|---|
| Assumptions: | | |
| Risk-free interest rate *(%)* | 1.82 | 2.03 |
| Expected life *(years)* | 3.63 | 3.67 |
| Expected volatility *(%)* | 38.20 | 39.21 |
| Expected dividend | CA$0.025/share quarterly | CA$0.025/share quarterly |
| Results: | | |
| Weighted average fair value of options granted *(per option)* | CA$0.30 | CA$ 0.50 |

b. 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. SUs vest three years from the date of grant. 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 year ended December 31, 2019, the Company recognized a share-based payment charge against income of $0.8 million (2018: $1.0 million) for the SUs granted during the year.

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

## 11. SHARE BASED COMPENSATION (continued)

| | Number of share units | Estimated fair value at date of grant (CA$) |
|---|---|---|
| **Balance at December 31, 2017** | 1,401,590 | $ 2.53 |
| February 27, 2018 grant | 364,000 | 2.36 |
| April 2, 2018 grant | 125,000 | 2.05 |
| April 12, 2018 dividend | 21,213 | 2.08 |
| May 14, 2018 vesting | (490,661) | 2.30 |
| May 31, 2018 vesting | (327,049) | 2.66 |
| June 21, 2018 dividend | 12,601 | 2.17 |
| June 29, 2018 grant | 140,000 | 2.11 |
| September 20, 2018 dividend | 13,848 | 2.25 |
| December 20, 2018 dividend | 22,503 | 1.40 |
| **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** |

## 12. PRINCIPAL SUBSIDIARIES

The Company had the following subsidiaries at December 31, 2019 and 2018:

| Name | Country of incorporation and place of business | Nature of business | Proportion of shares directly held by the Company (%) | Proportion of shares held by the group (%) |
|---|---|---|---|---|
| African Diamonds Ltd. | UK | (1) | 100 | - |
| Clara Diamond Solutions Limited Partnership (formerly, Clara Diamond Solutions Corp.) | Canada | Diamond sales platform | 99.9 | 0.1 |
| Clara Diamond Solutions GP Inc.(2) | Canada | (1) | 100 | - |
| Lucara Management Services Ltd. | UK | (1) | 100 | - |
| Lucara Diamond Holdings Inc. | Mauritius | (1) | 100 | - |
| Mothae Diamond Holdings Inc. | Mauritius | (1) | - | 100 |
| Boteti Diamond Holdings Inc. | Mauritius | (1) | - | 100 |
| Wati Ventures (Pty) Ltd. | Botswana | (1) | - | 100 |
| Debwat Exploration (Pty) Ltd. | Botswana | (1) | - | 100 |
| Lucara Botswana (Pty) Ltd. (formerly, Boteti Mining (Pty) Ltd.) | Botswana | Mining of diamonds | - | 100 |

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

(1) Intermediate holding company
(2) Incorporated on July 31, 2019.

All subsidiary undertakings are included in the consolidation. The proportion of the voting rights in the subsidiary undertakings held directly by the parent company do not differ from the proportion of ordinary shares held.

## 13. ADMINISTRATION

| | | 2019 | | 2018 |
|---|---|---|---|---|
| Salaries and benefits | $ | 5,943 | $ | 5,796 |
| Severance | | - | | 2,343 |
| Professional fees | | 2,612 | | 1,549 |
| Office and general | | 1,554 | | 1,458 |
| Marketing | | 949 | | 1,077 |
| Stock exchange, transfer agent, shareholder communication | | 369 | | 397 |
| Travel | | 822 | | 1,082 |
| Share-based compensation (Note 11) | | 1,186 | | 1,447 |
| Management fees | | 458 | | 461 |
| Depreciation | | 1,679 | | 426 |
| Donations | | 79 | | 355 |
| | **$** | **15,651** | $ | 16,391 |

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

## 14. INCOME TAXES

| | | 2019 | | 2018 |
|---|---|---|---|---|
| Current | $ | 14,470 | $ | 5,857 |
| Deferred | | (11,022) | | 6,688 |
| Income tax expense | **$** | **3,448** | $ | 12,545 |

Income tax expense differs from the amount that would result from applying the Canadian federal and provincial income tax rates to net income before tax. These differences result from the following items:

| | | 2019 | | 2018 |
|---|---|---|---|---|
| Statutory tax rate | | 27.00% | | 27.00% |
| Net income before tax | | 16,162 | | 24,197 |
| Computed income tax expense | | 4,364 | | 6,533 |
| Differences between Canadian and foreign tax rates | | (1,257) | | (1,564) |
| Non-deductible expenses and other permanent differences | | 1,615 | | 888 |
| Deferred tax effect of Botswana variable tax rate in excess of Botswana standard tax rate | | (3,120) | | 1,225 |
| Change in deferred benefits not recognized | | 1,783 | | 2,190 |
| Exchange rate differences | | 223 | | 876 |
| Withholding taxes | | (160) | | 2,397 |
| | $ | 3,448 | $ | 12,545 |

The Company is subject to a variable tax rate in Botswana based on a profit and revenue ratio which increases as profit as a percentage of revenue increases. The lowest variable tax rate is 22% while the highest variable tax rate is 55% (only if taxable income were equal to revenue). The Company has estimated the variable tax rate to be 33.59% for deferred income taxes based on current financial performance and the life of mine plan.

The Company has not recognized deferred tax liabilities in respect of historical unremitted earnings from foreign subsidiaries for which the Company is able to control the timing of the remittance and which are considered by the Company to be reinvested for the foreseeable future. At December 31, 2019, these earnings amount to $157.8 million (2018: $122.5 million). All of these earnings would be subject to withholding taxes if they were remitted by the foreign subsidiaries.

The movement in deferred tax liabilities during the year, without taking into consideration the offsetting balances within the same tax jurisdiction, is as follows:

| | | 2019 | | 2018 |
|---|---|---|---|---|
| **Balance, beginning of year** | $ | 73,482 | $ | 72,919 |
| Deferred income tax (recovery) expense | | (11,022) | | 6,688 |
| Foreign currency translation adjustment | | 555 | | (6,125) |
| **Balance, end of year** | **$** | **63,015** | $ | 73,482 |

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

| **Deferred income tax assets and liabilities recognized** | | **2019** | | **2018** |
|---|---|---|---|---|
| *Deferred income tax assets* | | | | |
| Non-capital losses | $ | 180 | $ | 300 |
| Accounts payable and other | | 731 | | 861 |
| Unrealized foreign exchange loss | | 1,003 | | 680 |
| Restoration provisions | | 7,937 | | 6,780 |
| Total deferred income tax assets | | 9,851 | | 8,621 |
| *Deferred income tax liabilities* | | | | |
| Mineral properties, plant and equipment | | 72,422 | | 79,814 |
| Future withholding taxes | | 444 | | 2,289 |
| Deferred income tax liabilities | | 72,866 | | 82,103 |
| Deferred income tax liabilities, net | **$** | **63,015** | $ | 73,482 |

| **Deferred income tax assets not recognized** | | **2019** | | **2018** |
|---|---|---|---|---|
| Tax losses | $ | 22,581 | $ | 20,393 |
| Mineral property, plant and equipment | | 110 | | 40 |
| Other deductible temporary differences | | 273 | | 263 |
| | **$** | **22,964** | $ | 20,696 |

As at December 31, 2019, the Company has non-capital losses for income tax purposes which expire as follows:

| | **2020** | **2021** | **2022** | **Subsequent to 2023** | **No expiry date** | **Total** |
|---|---|---|---|---|---|---|
| Canada | $ - | $ - | $ - | $ 74,139 | $ - | **$ 74,139** |
| United Kingdom | - | - | - | - | 5,879 | **5,879** |
| | $ - | $ - | $ - | $ 74,139 | $ 5,879 | **$ 80,018** |

No tax benefit has been recorded for the Canadian and United Kingdom non-capital losses.

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

## 15. EARNINGS PER COMMON SHARE

a) *Basic*

Basic earnings per common share are calculated by dividing the net income attributable to the shareholders of the Company by the weighted average number of common shares outstanding during the year:

| | | 2019 | | 2018 |
|---|---|---|---|---|
| Income for the year | $ | 12,714 | $ | 11,652 |
| Weighted average number of common shares outstanding | | 396,790,950 | | 394,008,955 |
| | **$** | **0.03** | $ | 0.03 |

b) *Diluted*

Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding to assume conversion of all dilutive potential common shares. For stock options, a calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average market share price of the Company's outstanding shares for the year), based on the exercise prices attached to the stock options. The number of shares calculated above is compared with the number of shares that would have been issued assuming the exercise of stock options. Share units are, by their nature, dilutive and included in the calculation on a weighted average basis during the year.

| | | 2019 | | 2018 |
|---|---|---|---|---|
| Income for the year | $ | 12,714 | $ | 11,652 |
| Weighted average number of common shares outstanding | | 396,790,950 | | 394,008,955 |
| Adjustment for stock options | | - | | 5,070 |
| Adjustment for share units | | 1,121,864 | | 1,499,680 |
| Weighted average number of common shares for diluted earnings per share | | 397,912,814 | | 395,513,705 |
| | **$** | **0.03** | $ | 0.03 |

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

## 16. RELATED PARTY TRANSACTIONS

*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:

| | | 2019 | | 2018 |
|---|---|---|---|---|
| Salaries and wages, including directors' fees | $ | 2,499 | $ | 2,759 |
| Severance | | - | | 2,343 |
| Short term benefits | | 82 | | 255 |
| Share-based compensation | | 573 | | 1,208 |
| | **$** | **3,155** | $ | 6,565 |

*a) Clara acquisition*

At the time of Lucara's acquisition of Clara, a current director and a current officer of the Company were also shareholders of Clara and received 1,192,000 common shares and 50,000 common shares, respectively, of Lucara. If all of the Clara performance milestones (Note 9) are reached, these individuals will receive an additional 1,788,001 common shares and 74,999 common shares, respectively, of Lucara. Following the acquisition of Clara, Lucara appointed a new director and a new officer, each of whom had been a shareholder of Clara at the time of its acquisition by the Company. If all of the Clara performance milestones are reached, these individuals will be entitled to receive an additional 600,000 common shares and 74,999 common shares of Lucara.

Pursuant to the profit sharing mechanism described in Note 9, a total of 3.45% of the EBITDA generated by the platform has been assigned to two directors of Lucara, each of whom was a founder of Clara. A further 3.22% of the EBITDA generated by the platform may be distributed to members of management, at the discretion of Lucara's Compensation Committee, based on the achievement of key performance targets. In March 2019, the EBITDA sharing agreement was amended such that one of the two founders and the Clara Management waived their respective rights to the EBITDA payment to the extent that such payment relates to net income earned by Clara on the sale of rough diamonds from the Karowe Mine. The waiver is effective from the date of the share purchase agreement in February 2018 through to December 31, 2020. No amounts have been paid under this profit sharing mechanism in 2019 and 2018.

*b) Other related parties*

For the year ended December 31, 2019, the Company paid $0.1 million (2018: $0.4 million) to a charitable foundation directed by certain of the Company's directors to carry out social programs on behalf of the Company in Botswana. For the year ended December 31, 2019, the Company paid $0.5 million (2018: $0.5 million) to a management company directed by certain of the Company's directors for office space and office management services.

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

## 17. SEGMENT INFORMATION

The Company's primary business activity is the development and operation of diamond properties in Botswana. The Company has two operating segments: Karowe Mine and Corporate and other. The Company's assets and operations in Clara are included under Corporate and other.

**2019**

| | Karowe Mine | Corporate and other | Total |
|---|---|---|---|
| Revenues[1] | $ 191,937 | $ 604 | $ 192,541 |
| Income from mining operations | 44,620 | (237) | 44,383 |
| Exploration expenditures | (4,572) | - | (4,572) |
| Finance expenses | (2,595) | (523) | (3,118) |
| Foreign exchange loss | (2,290) | (344) | (2,634) |
| Other | (7,867) | (10,030) | (17,897) |
| Taxes | (3,448) | - | (3,448) |
| **Net income (loss) for the year** | **23,848** | **(11,134)** | **12,714** |
| **Capital expenditures** | **(26,741)** | **(404)** | **(27,145)** |
| **Total assets** | **319,080** | **26,951** | **346,031** |

**2018**

| | Karowe Mine | Corporate and other | Total |
|---|---|---|---|
| Revenues[1] | $ 176,191 | $ - | $ 176,191 |
| Income from mining operations | 51,509 | (73) | 51,436 |
| Exploration expenditures | (3,359) | - | (3,359) |
| Finance expenses | (2,183) | (369) | (2,552) |
| Foreign exchange (loss) / gain | (2,449) | 111 | (2,338) |
| Other | (6,873) | (12,117) | (18,990) |
| Taxes | (12,131) | (414) | (12,545) |
| Net income (loss) for the year | 24,514 | (12,862) | 11,652 |
| Capital expenditures | (58,820) | (1,881) | (60,701) |
| Total assets | 342,186 | 28,709 | 370,895 |

[1] During the year ended December 31, 2019, one customer generated 12% of the Company's 2019 revenue. During the year ended December 31, 2018, no customers generated more than 10% of the Company's total revenue.

The geographic distribution of non-current assets is as follows:

| | Plant and equipment 2019 | Plant and equipment 2018 | Mineral properties 2019 | Mineral properties 2018 | Other 2019 | Other 2018 |
|---|---|---|---|---|---|---|
| Canada | $ - | $ - | $ - | $ - | $ 23,015 | $ 21,830 |
| Botswana | 130,108 | 147,246 | 105,243 | 113,109 | 5,168 | 3,706 |
| | $ 130,108 | $ 147,246 | $ 105,243 | $ 113,109 | $ 28,183 | $ 25,536 |

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

$0.4 million of depletion expense in 2019 (2018 - $nil) relates to intangible assets located in Canada. All remaining depletion and amortization expense relates to the assets at the Karowe Mine located in Botswana.

## 18. FINANCIAL INSTRUMENTS

a) *Measurement categories and fair values*

As explained in Note 3, 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.

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).

| | December 31, 2019 | December 31, 2018 |
|---|---|---|
| Level 1: Fair value through other comprehensive income – Investments | $ 241 | $ 920 |
| 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 December 31, 2019, 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 $0.9 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. The 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.

## 18. FINANCIAL INSTRUMENTS (continued)

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.

*Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. Cash flow forecasting is performed in the operating entities of the Company and aggregated in the head office. Rolling forecasts of the Company's liquidity requirements are monitored to ensure it has sufficient cash to meet operational needs at all times. Such forecasting takes into consideration the Company's debt financing plans.

*Revolving credit facility*

The Company holds a $50 million revolving term credit facility with the Bank of Nova Scotia expiring in Q2 2020. This facility may be extended if both parties agree. 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 at December 31, 2019, the Company is 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 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.

The Bank of Nova Scotia has first ranking security over the Karowe assets.

As at December 31, 2019, no amount was drawn on the facility for working capital purposes (2018 - $10.0 million). The current interest rate on the amount drawn is LIBOR plus a margin of 2.75%. At December 31, 2019, $50.0 million was available.

## 19. CAPITAL MANAGEMENT

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to pursue the development of its mineral properties and to maintain a flexible capital structure which optimizes costs of capital at an acceptable risk.

In the management of capital, the Company considers items included in equity attributable to shareholders and its debt facility to be capital.

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the Company's assets. In order to maintain or adjust the capital structure, the Company may attempt to issue new shares or debt instruments, acquire or dispose of assets, or to bring in joint venture partners.

In order to facilitate the management of its capital requirements, the Company prepares annual expenditures budgets and life-of-mine plans which are updated as necessary depending on various factors, including successful capital deployment and general industry conditions. The annual and updated budgets and life-of-mine plan are approved by the Board of Directors.