Lucara Diamond Corp.

MD & A and Consolidated Financial Statements

Year Ending:
December 31, 2011

LUCARA DIAMOND CORP.
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2011

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, 2011, which are prepared in accordance with International Financial Reporting Standards. All amounts are expressed in U.S. dollars unless otherwise indicated. The effective date of this MD&A is March 22, 2012.

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.

HIGHLIGHTS

Corporate

- Closed a CDN$60 million private placement in February 2011.
- Completed a $50 million debenture financing in early July 2011.
- The Company commenced trading on the Toronto Stock Exchange in August 2011, the Botswana Stock Exchange in July 2011 and the NASDAQ QMX First North in Sweden in November 2011.
- In February 2012, the Company received a commitment letter from the Bank of Nova Scotia for a $25 million revolving term credit facility. Upon closing of the facility, the Company intends to use the facility to fund ongoing operations primarily at the Karowe Mine in Botswana.

Karowe Mine - Botswana (formerly AK6 Diamond Project)

- Construction of the Karowe mine is expected to be substantively complete by the end of March with commissioning scheduled for April.
- As at December 2011, the project had achieved 1,000,000 hours without a lost time injury (LTI) and no environmental incidents have been recorded.
- The project is trending within the approved capital budget of $120 million, and expenditure to the end of December 2011 was 71% of budget with a total of 97% of the capital budget being committed.
- The Company commissioned an updated valuation of the Karowe diamonds recovered to date, resulting in a 24% increase in overall modeled value to $301 per carat at a 1.5 mm cut-off size.
- In December 2011, the Company officially renamed the AK6 Diamond Project to the Karowe Mine to better reflect the significance of the new mine. The name Karowe means "precious stone" in the local dialect.

- The overhead power line from the Orapa sub-station to site has been completed. The Karowe sub-station has been commissioned providing direct access to grid power.

- In Gaborone, the diamond sorting, sales and marketing offices have been completed and senior diamond sorting personnel have been recruited. The installation of the security systems and stock control systems has commenced.

Mothae Diamond Project - Lesotho

- Total diamond sales in 2011 were 16,659 carats for gross proceeds of $14.6 million (average of $881 per carat). A sale of 7,190 carats of diamonds in December 2011 realized gross proceeds of $6.4 million (average of $893 per carat). The December sale included a 56.62 white Type IIa, which sold for $2.01 million – a record price for a single stone produced from Mothae.

- An upgrade to the bulk sample plant crushing circuits was completed enabling it to handle hard fresh kimberlite which is to be mined in 2012. The diamond recovery circuit was upgraded by interlocking of the Bourvestnik high intensity x-ray diamond recovery unit into the primary plant material flow.

- The Mothae Project Environmental Impact Assessment study (EIA) based on the Company's 2009 Conceptual Mining Study was completed and submitted to the Lesotho Department of Environment. The EIA was approved by the Lesotho Department of Environment in the fourth quarter of 2011.

- During October, a contract was awarded to ADP Project, to conduct a pre-feasibility level study in support of preliminary economic assessment on Mothae. The objective of this study will be to gain an increased understanding of the economic potential of the Mothae project through greater definition of the capital and operating costs required for the development of a mine at Mothae.

- The Phase 2 delineation drilling program was initiated. The drilling program is designed to extend the Mothae geologic model from 200 meter depth to 320 meter depth to provide sufficient detail for modelling the internal geology of the Mothae pipe. Incorporated into the drilling program are core holes specifically designated to collect material for ore dressing studies and core holes specifically designated to collect geotechnical information for open pit mine design.

INTRODUCTION

The Company is a diamond development company focused in Africa. The business of the Company consists of the acquisition, exploration, development and operation of diamond properties. The Company's head office is in Vancouver, BC, Canada and its common shares trade on the Toronto Stock Exchange, the Botswana Stock Exchange and NASDAQ QMX First North in Sweden under the symbol "LUC".

The principal assets of the Company and the focus of the Company's development and exploration activities are its interests in assets in Lesotho and Botswana. Following an evaluation of the exploration work conducted to date on the Kavango Project in eastern Namibia, by the Company and its joint venture partner, Namdeb Diamond Corporation, the Company has made a determination not to renew the licenses. The Company continues to actively seek development and growth opportunities to bring new projects into its portfolio.

DEVELOPMENT AND EXPLORATION UPDATE

The following summarizes the Company's current land holdings:

Country	Project Name and Interest Held	Area (km2)
Botswana	Boteti AK6 Diamond License (100% interest)	15.3
Lesotho	Mothae Diamond Mining Lease (75% interest)	20.0

Karowe Mine, Botswana

The Company was granted a mining license in 2008 over the AK6 Diamond Project which is located in central Botswana and is part of the Orapa/Letlhakane kimberlite district, one of the world's most prolific diamond producing areas. The kimberlite consists of three lobes, South, Center and North, of which the South Lobe makes up approximately 75% of the kimberlites' resource potential. The pipe has an area of 4.2 hectares at the surface which expands to 7 hectares at a depth of 120 meters.

In July 2010, a formal decision was made to proceed with the construction of the AK6 diamond mine which is estimated to require a capital investment of approximately $120 to $130 million (based on a ZAR/USD exchange rate of R7.53), which includes the process plant and all mine site and off-site infrastructures. In December 2011, the AK6 diamond mine was renamed to the Karowe Mine.

The project has an Indicated Resource of 51 million tonnes ("mt") containing an estimated 8.2 million carats ("ct") of diamonds. The mine design delineates a Probable Reserve of 36.2 million tonnes of ore, containing an estimated 6.3 million carats of diamonds at a 1.5mm bottom cut-off size, in an open pit to a depth of 324 meters. The reserves will be mined over an estimated 15 year life. The process plant has been designed at an estimated throughput rate of 2.5 million tonnes per annum ("mtpa"). Diamond recovery is estimated at approximately 400,000 carats per year at a November 2011 diamond price of $301/ct.

Performance during the year ended December 31, 2011

In 2011, activities across engineering, procurement, construction and the development of the operations team advanced the project significantly. By year end, engineering, procurement and fabrication activities were essentially complete and project construction was standing at over 90% complete. Delays to the project schedule as a result of the steel industry industrial action in July impacted the overall project schedule and the handover to operations shifted from the end of 2011 to early in the second quarter of 2012.

As at December 2011, the project had achieved 1,000,000 hours without a lost time injury (LTI) and no environmental incidents have been recorded.

Environmental and community relations activities as detailed in the Environmental Management Plan were well executed throughout the year. A competition to name the mine as it transitions into production was well supported by the local communities and schools and Karowe (meaning "previous stone" in the local dialect) was selected. Several community projects, including village clean-up campaigns and health and wellness initiatives, in conjunction with the community members were completed. Archaeological monitoring of all construction areas continued throughout the year and no artefacts were discovered on site or at the Boteti housing sites in Letlhakane.

The 25km, 33kVA power-line from the Orapa sub-station to the Karowe Mine site sub-station was completed during the last quarter of 2012 and handed over to BPC. The mine switched to grid power in time to support commissioning activities.

The mine operations contract with Kalcon was concluded mid-year and the contractor mobilized to site in October. The initial mine development has gone according to plan, ore boundaries match the resource model and initial ore benches have been established. At December 31, 2011, an ore stockpile of 230,000 tonnes [containing 87,000 carats (37.8 cpht)] had been established to support commissioning activities with 552,000 tonnes of waste having been removed and stockpiled.

The process plant operations and maintenance contract was also concluded, and the Company's contractor, Minopex has site established. Minopex are working with the operations staff on process stores and operational procedures and are also fully integrated with the commissioning planning.

The operations senior management, technical and support staff were successfully recruited as required to support project advancement throughout the year.

In Gaborone, the sales and marketing offices were completed and the senior staff recruited. The installation of the security systems and the stock control systems commenced in the fourth quarter.

Mothae Diamond Project, Lesotho

The Mothae project is located in northeast Lesotho and is a large low grade kimberlite which contains a significant population of large, high value Type IIa diamonds.

Mothae Diamonds (PTY) Ltd. ("Mothae Diamonds"), a 75% owned subsidiary of the Company, holds a 100% interest in the Mothae project. The other 25% is owned by the Government of Lesotho. The Company, through a wholly owned subsidiary, is the project operator. One half of the project interest held by the Government (i.e. 12.5% of the project interest) is a free carried interest and the other 12.5% will ultimately be paid for by the Government through its share of future project dividends.

In 2010, the Company commenced a trial mining program, based on results from a 100,000 tonne bulk sample completed in 2009. The trial mining program is designed to sample and process up to an additional 620,000 wet tonnes of kimberlite from various kimberlite domains identified within the pipe to confirm the occurrence of high value Type IIa diamonds and to better assess the economic potential of the Mothae kimberlite. Sealed tender diamond sales are being undertaken to establish diamond value. In 2011, diamond sales were conducted in March and December.

Performance during the year ended December 31, 2011

Mothae Diamonds processed 31,488 dry tonnes (36,430 wet tonnes) of kimberlite in the fourth quarter of 2011 recovering 796.97 carats of diamond. In 2011, Mothae Diamonds processed 208,293 dry tonnes (244,532 wet tonnes) of kimberlite recovering 12,157.35 carats of diamond. Table 1 summarizes Mothae production for the trial mining program which commenced in June 2010.

Table1. Mothae Trial Mining Results as of December 31, 2011

Fiscal Period	Bulk Sample	Wet Tonnage	Dry Tonnage	Stones	Carats*	Average Stone Size (cts/stone)	Dry Grade (cpht)*
2010	F1D	1,769	1,592	111	77.65	0.70	4.88
	C4A	33,785	29,649	1,458	759.23	0.52	2.56
	C5A	58,427	48,542	3,133	1,120.07	0.36	2.31
	C6A	8,122	7,296	529	260.50	0.49	3.57
	C8A	58,590	49,152	3,522	1,442.13	0.41	2.93
January 1 to September 30, 2011	C9A	47,797	40,370	3,841	1,940.71	0.51	4.81
	G2A	40,185	33,691	4,256	1,909.78	0.45	5.67
	F2A	59,692	50,181	4,083	1,979.66	0.48	3.95
	G2B	25,931	22,689	3,022	1,286.89	0.43	5.67
	G3A	34,497	29,874	3,722	1,654.70	0.44	5.54
October 1 to December 31, 2011	C7A	21,287	18,425	875	403.20	0.46	2.19
	C6B	11,215	9,592	572	348.02	0.61	3.63
	E2A	3,928	3,471	98	45.75	0.47	1.32
	Totals	**405,225**	**344,524**	**29,222**	**13,228.29**	**0.45**	**3.84**

* All samples processed using a bottom cut-off size of 2mm; carats and sample grade represent diamonds greater than 2mm in size.

Plant throughput was reduced in the fourth quarter of 2011 as a result of a shutdown in November to complete upgrades to the plant crushing and diamond recovery circuits. These included integration of a new secondary crushing circuit required to handle harder kimberlite material as mining operations move deeper into less weathered, fresher kimberlite and interlocking of a Bourevestnik high intensity diamond recovery unit into the main plant circuit. In December, the plant operated at a reduced throughput as part of the commissioning of these upgrades.

Samples G3A, C7A and C6B were completed in the fourth quarter with overall results shown in Table 1. A small tonnage of sample E2A was also processed as part of the commissioning of plant upgrades.

The bulk of sample G3A was processed in the third quarter of 2011 and the sample was completed in the fourth quarter. A total of 3,722 diamonds weighing 1,654.70 carats were recovered from 29,874 dry tonnes (34,497 wet tonnes) yielding a sample grade of 5.54 carats per hundred tonnes (cpht) and an average stone size of 0.44 carats/stone. Recoveries included 2 stones between 10 and 20 carats, 19 stones between 5 and 10 carats and 68 stones between 2 and 5 carats. The three largest diamonds recovered were 19.94, 11.81 and 10.97 carats.

Sample C7A yielded 875 diamonds weighing 403.20 carats from 18,425 dry tonnes (21,287 wet tonnes) for a sample grade of 2.19 cpht. Recoveries included one diamond weighing 56.62 carats, 4 stones between 5 and 10 carats and 14 stones between 2 and 5 carats. The three largest diamonds recovered were 56.62, 8.06 and 6.62 carats.

Sample C6B produced 572 diamonds weighing 348.02 carats from 9,592 dry tonnes (11,215 wet tonnes) for a sample grade of 3.63 cpht. C6B yielded one stone larger than 10 carats, 6 stones between 5 and 10 carats and 18 stones between 2 and 5 carats. The three largest diamonds recovered were 10.52, 8.59 and 8.58 carats. Sample C6B comprised the remaining portion of sample C6A which was excavated and partially processed in 2010 (Table 1). Sample C6B is that portion of the C6 sample which was stockpiled pending upgrade of the process plant crushing circuits.

No grease table audits of x-ray recovery tailings were conducted during the quarter and diamond grades reported above are subject to change pending audit results.

Tonnage estimates are based on daily plant weightometer readings and moisture content measurements to determine a dry tonnage estimate. The process plant is being operated by Minopex under contract to Mothae Diamonds and operates at a 2mm bottom cut off size for diamond recovery. Diamond recovery and characterization work is carried out by the Mothae Diamonds diamond sorting staff with recovery results being monitored and reported by Remote Exploration Services, also under contract to Mothae Diamonds.

In August 2011, Mothae Diamonds acquired a Bourevestnik X-ray (high powered X-ray) diamond recovery machine in an effort to improve recovery of low luminescent, potentially high value Type IIa diamonds. The Bourevestnik unit was initially tested and commissioned in an audit capacity to audit recovery tailings from the Flowsort and VE x-ray diamond recovery units in the main plant circuit. In the fourth quarter of 2011, the Bourevestnik unit was interlocked into the main plant circuit as the primary large diamond recovery facility, bypassing the Flowsort unit, which has been taken offline.

During the year, a primary crushing unit and a secondary crushing unit were installed and commissioned. Both units are required to efficiently process harder kimberlite and basalt xenoliths and in particular, to process unweathered kimberlite samples that are planned in 2012.

A drilling contact was awarded to Remote Drilling Services to conduct a 5,400m delineation drilling program. The objectives of the program are to define the internal geology of the Mothae kimberlite as well as to extend the currently defined kimberlite volume from a depth of 200m to 320m, to collect suitable sample material for ore dressing studies and to collect core for geotechnical evaluation.

During October 2011, a contract was awarded to ADP Projects to complete a preliminary economic assessment of the Mothae kimberlite. The objective of this study will be to gain an increased understanding of the economic potential of the Mothae project through greater definition of the capital and operating costs required for the development of a mine at Mothae.

Two diamond sales were completed during the year. The first took place in March 2011 which sold a total of 9,379 carats for gross proceeds of $8.2 million (average of $871 per carat). The second took place in December 2011 which sold a total of 7,190 carats for gross proceeds of $6.4 million (average of $893 per carat).

During the third quarter of 2011, Mothae Diamonds completed an Environmental Impact Assessment (EIA) of the Mothae project based on a conceptual mining study completed by the Company in 2009. The EIA has been submitted to and approved by the Lesotho Department of Environment.

Namibia

Following an evaluation of the exploration work conducted to date on the Kavango Project in eastern Namibia by the Company and its joint venture partner, Namdeb Diamond Corporation, the Company has made a determination not to renew the licenses which expired at October 29, 2011. The Company is currently preparing the documentation required to formally relinquish its interest in all ten of the prospecting licenses.

SELECT ANNUAL FINANCIAL INFORMATION

	Year ended December 31, 2011	Year ended December 31, 2010	Five months ended December 31, 2009 (Cdn GAAP)
Statement of operations data			
Exploration expenditures	$ 6,618,233	$ 11,578,718	$ 591,370
Operating expenses	8,182,622	4,455,697	2,004,577
Gain on sale of diamonds	(2,339,282)	-	-
Net loss attributable to shareholders of the Company	18,126,567	13,309,889	12,809,199
Data per common share			
Basic and diluted loss per common share	$ 0.05	$ 0.06	$ 0.12
Balance sheet data			
Total assets	$ 241,287,381	$ 145,533,082	$ 143,872,879
Long-term liabilities	43,349,815	567,697	18,275,048

RESULTS OF OPERATIONS

The Company's net loss attributable to the shareholders of the company for the year ended December 31, 2011 was $18.1 million or $0.05 per share compared to a net loss for the year ended December 31, 2010 of $13.3 million or $0.06 per share. The net loss for the five months ended December 31, 2009 was $12.8 million or $0.12 per share.

The higher net loss for the current period as compared to the two prior periods presented is primarily due to increased expenditures relating to the trial mining program at Mothae offset by two diamond sales during the year. In addition, the Company incurred administrative expenses associated with the Company's listing on the TSX, the Botswana Stock Exchange and the NASDAQ QMX First North in Sweden, a donation to the Lundin Foundation and an overall increase in corporate development initiatives during the year.

The operating losses are a reflection of the Company's status as a company which is developing diamond deposits and is not yet producing revenue. The Company currently has no main source of income although revenue is being generated through the sale of diamonds recovered during the trial mining program at Mothae. The Company's goal is to develop profitable diamond mining operations at both Mothae and Karowe and until this goal is achieved, losses are expected to continue.

SUMMARY OF QUARTERLY RESULTS *(unaudited)*

Three months ended	Dec-11	Sept-11	Jun-11	Mar-11	Dec-10	Sep-10	June-10	Mar-10
A. Total revenues	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
B. Exploration expenditures	(564,851)	3,116,383	2,866,454	1,200,247	2,688,388	2,508,938	3,841,882	2,539,510
C. Administration expenses	2,254,982	1,304,914	1,845,748	2,776,978	1,821,675	815,463	890,349	928,210
D. Net loss	5,438,374	5,453,107	5,921,521	1,860,890	4,821,819	3,143,966	4,298,452	3,366,995
E. Loss per share (basic and diluted)	0.01	0.01	0.02	0.01	0.02	0.01	0.02	0.02

Operating expenses and net loss, quarter over quarter, vary in relation to the level of activities undertaken by the Company during the financial quarters reported. These activities include corporate development initiatives, net exploration expenditures incurred and stock-based compensation recognized during the quarter.

Exploration expenditures

The exploration expenditures for the past six quarters relate primarily to the on-going trial mining program, which commenced in May 2010 at Mothae, offset in part by the value of diamonds recovered and sold, based on management's best estimate at the time of recovery. The difference between the carrying value and the subsequent proceeds from the sale of diamonds is treated as a gain or loss as it is a change in market conditions during the period. Included in exploration expenditures for the first half of 2010 is the cost to complete the definitive feasibility study of $2.7 million for the Karowe Mine. Based on the results of the study, the project was determined to be commercially feasible in July 2010, and pursuant to the Company's accounting policy for mineral properties, expenditures incurred thereafter have been capitalized.

Administration expenses

The increase in administration expenses for the three months ended December 31, 2011 compared to the same quarter in 2010 is due primarily to the costs associated with the Company's listing on the NASDAQ QMX First North in Sweden and additional salaries.

Net loss

Net loss for the three months ended December 31, 2011 was $5.4 million reflecting increased administrative expenses, financing fees and foreign exchange losses.

The net loss for the year ended December 31, 2011 was $18.7 million. This reflects the exploration and depreciation costs at Mothae, net of two diamond sales of 16,571 carats for gross proceeds of $14.6 million. The sales included the rough diamond inventory that was held at December 31, 2010, which was valued using the Company's best estimate of the lower of cost and net realizable value. The Company has recorded a gain on the sale of this inventory in the amount of $2.3 million. The remaining proceeds from the sales have been netted against exploration expenditures.

LIQUIDITY AND CAPITAL RESOURCES

As at December 31, 2011, the Company had cash and cash equivalents of $48.6 million and working capital of $29.0 million, as compared to cash and cash equivalents of $32.9 million and working capital of $31.2 million at December 31, 2010.

Cash used in operating activities for the year ended December 31, 2011 was $11.7 million, and consists mainly of the net loss of $18.7 million adjusted for the impact of non-cash items including depreciation expense of $2.6 million, and changes in non-cash working capital items.

Net cash from financing activities for the year ended December 31, 2011 was $107.4 million, results from a private placement completed in February 2011, and the completion of a $50 million debenture financing in July 2011.

Net cash used in investing activities for the year ended December 31, 2011 was $77.2 million for expenditures primarily related to the development of the Karowe Mine. In conjunction with the development of the Karowe Mine, the Company has purchase commitments of $11.5 million and estimated remaining capital expenditures of approximately $35 million.

In February 2012 the Company received a commitment letter from the Bank of Nova Scotia for a $25 million revolving term credit facility. Upon closing of the facility, the Company intends to use the facility to fund ongoing operations primarily at the Karowe Mine in Botswana. The availability of the facility is subject to the completion of final documentation and customary conditions precedent. The two year facility will be secured by the assets of the Company and certain of its subsidiaries. Up to $15 million may be advanced prior to the delivery of security over the Company's Karowe assets.

FUTURE PLANS AND OUTLOOK

Boteti Karowe Mine, Botswana

The Company expects construction of the 2.5 mtpa production facility at the Karowe mine to be complete within the first quarter of 2012. As construction activities are completed, available systems will be commissioned with full plant commissioning being completed in the second quarter of 2012. This will be followed by the ramp-up to full production which will include plant optimization activities.

The Company expects the first sale of diamonds from Karowe to take place at its dedicated sales and marketing facilities in Gaborone in the second quarter of 2012.

Mothae Diamond Project, Lesotho

The Company intends to continue with trial mining program and project evaluation through to the end of the third quarter of 2012. In the first half of 2012, efforts will focus on mining and processing of 30,000 to 50,000 tonnes of fresh unweathered kimberlite to determine the diamond recovery characteristics of this material which makes up the bulk of Mothae's resource potential.

The completion of the 5,400m delineation drilling program by Remote Drilling Services is anticipated in the second quarter of 2012 with subsequent geological modelling being carried out in the third quarter. In addition, by the third quarter of 2012, the Company expects the completion of studies by ADP Projects which include geologic and resource modelling of the Mothae kimberlite with associated mine design, and detailed ore dressing studies to support process plant design. A preliminary economic assessment would then be completed in the fourth quarter of 2012.

The Company expects ongoing diamond recoveries and periodic sales of Mothae's diamonds during the trial mining phase.

ADJUSTMENT OF EQUITY TRANSFER TO THE GOVERNMENT OF LESOTHO ("GOL")

During the three months ended March 31, 2011, the Company re-evaluated its accounting for the transfer of shares and a share option in Mothae to the GOL during 2010. Previously, the Company had accounted for the transfer as an expropriation for no proceeds. The Company, after further review, has now concluded that it made a share-based payment in exchange for a mining license, which is capitalized as an intangible asset. The Company has made the following adjustments, as at and for the year ended December 31, 2010:

- Increased mineral property costs by $3,530,120, representing the fair value of the intangible mining rights received from the GOL as based upon the fair value of the shares in Mothae as of June 2010;

- Increased non-controlling interest ("NCI") by $2,263,286, representing the fair value of the 12.5% "free-carried" interest in Mothae transferred to the GOL as of June 2010;

- Increased contributed surplus by $1,266,834, representing the fair value, as of June 2010, of the GOL's option on the additional 12.5% interest in Mothae, which will beneficially transfer to the GOL upon their full payment for these shares. These shares are to be paid for by the GOL on a contingent basis, such that they are payable only from the first $1.825 million of dividends on these shares. Management have fair valued the option on these shares by using the fair value established for the NCI portion above and deducting the fair value of the $1.825 million, discounted at 10% per annum for a period of approximately 6 years until the cash flows from Mothae are estimated to be sufficient to cover the required payment; and

- Decreased the NCI by $708,049 representing the NCI share of losses of Mothae from the date of the related Shareholder Agreement, June 23, 2010, whereby the GOL received its 12.5% free-carried interest, to December 31, 2010. The increased allocation of the losses of Mothae for the year ended December 31, 2010 result in an equivalent decrease in the loss attributable to the shareholders of the parent company for the year and to the deficit at December 31, 2010.

The option on the 12.5% interest, which has been treated as contributed surplus, will continue to be treated as contributed surplus and no attribution of the income or losses of Mothae will be recorded until the shares have been paid for by way of future dividends. At that time the amount will be transferred from contributed surplus to NCI and the future NCI attribution will be based on 25%.

Management has deemed the magnitude of the adjustment to not be material, and accordingly has determined that a restatement of the December 31, 2010 consolidated financial statements was not warranted.

CHANGES IN ACCOUNTING POLICIES

International Financial Reporting Standards ("IFRS")

The Company has prepared its December 31, 2011 audited consolidated financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants which changed to IFRS, with an effective transition date of January 1, 2010. Subject to certain transition elections disclosed in Note 5 to the audited consolidated financial statements, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010 and throughout the periods presented, as if these policies had always been in effect.

The Company's IFRS accounting policies are disclosed in Note 3 of the audited consolidated financial statements for the year ended December 31, 2011. Reconciliation between the Company's financial statements as previously reported under Canadian GAAP and current reporting under IFRS is detailed in Note 5 of the audited consolidated financial statements.

NEW IFRS PRONOUNCEMENTS AND AMENDMENTS TO OTHER STANDARDS

Unless otherwise noted, the following revised standards and amendments are effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. The Company has not yet assessed the impact of these standards and amendments or determined whether it will early adopt them.

a) IFRS 9, *Financial Instruments,* was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

   Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, *Financial Instruments – Recognition and Measurement,* except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income.

b) IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces *SIC-12, Consolidation—Special Purpose Entities* and parts of IAS 27, *Consolidated and Separate Financial Statements*.

c) IFRS 11, Joint Arrangements, requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities—Non-monetary Contributions by Venturers*.

d) IFRS 12, *Disclosure of Interests in Other Entities*, establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosure that address the nature of, and risks associated with, an entity's interests in other entities.

e) IFRS 13, *Fair Value Measurement*, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures.

f) There have been amendments to existing standards, including IAS 27, *Separate Financial Statements* (IAS 27), and IAS 28, *Investments in Associates and Joint Ventures* (IAS 28). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

g) IAS 19, *Employee Benefits*, has been amended to make significant changes to the recognition and measurement of defined benefit pension expense and termination benefits and to enhance the disclosure of all employee benefits. The amended standard requires immediate recognition of actuarial gains and losses in other comprehensive income as they arise, without subsequent recycling to net income. Past service cost (which will now include curtailment gains and losses) will no longer be recognized over a service period but instead will be recognized immediately in the period of a plan amendment. Pension benefit cost will be split between (i) the cost of benefits accrued in the current period (service cost) and benefit changes (past-service cost, settlements and curtailments); and (ii) finance expense or income. The finance expense or income component will be calculated based on the net defined benefit asset or liability. A number of other amendments have been made to recognition, measurement and classification including redefining short-term and other long-term benefits, guidance on the treatment taxes related to benefit plans, guidance on risk/cost sharing features, and expanded disclosures.

h) IAS 1, *Presentation of Financial Statements*, has been amended to require entities to separate items presented in OCI into two groups, based on whether or not items may be recycled in the future. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately. The amendment is effective for annual periods beginning on or after July 1, 2012 with earlier application permitted.

CRITICAL ACCOUNTING ESTIMATES

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, 2011 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.

Mineral properties

The Company carries the acquisition costs of its mineral properties at 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. 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

Deferred income tax assets and liabilities are determined based on differences between the financial statement carrying values of assets and liabilities and their respective income tax bases ("temporary difference"), and losses carried forward. Deferred income tax assets and liabilities are measured using tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by year end. The effect on deferred income tax assets and liabilities of a change in tax rates is included in operations in the period in which the change is substantively enacted. The amount of deferred income tax assets recognized is limited to the extent that it is probable that future tax profits will be available against which the temporary difference can be utilized.

Management of the Company is required to exercise judgments and make assumptions about the future performance of the Company in determining its ability to utilize loss carry-forwards and realize the benefits of deferred income tax assets.

Stock-based compensation

In calculating the fair value of stock options granted, management is required to make significant estimates in relation to the future volatility of the Company's share price and the period in which stock options will be exercised. Selection of a volatility factor and the estimate of the expected option life will have a significant impact on costs recognized for stock-based compensation. Estimates concerning volatility are made with reference to historical volatility, which is not necessarily an accurate indicator of volatility that will be experienced in the future. Management assumes that stock options will be exercised prior to their expiry date.

RELATED PARTY TRANSACTIONS

During the year ended December 31, 2011, The Company incurred the following expenses with Namdo Management Services Limited ("Namdo") and Lundin Foundation ("LF"), companies related by way of directors in common. In the prior year, the Company incurred air chartered services from Mile High Holdings Ltd. ("Mile High"), a company associated with the Chairman of the Company. The Company also incurred professional geological services and laboratory related expenditures from the Mineral Services Group ("MS Group"), a company that is associated with a director of Company.

Description of services	Related party	2011	2010
Management fees	Namdo	$ 505,850	$ 349,416
Donations	LF	607,020	-
Exploration related expenditures	MS Group	125,598	639,472
Aircraft charter	Mile High	-	41,064
		$ 1,238,468	$ 1,029,952

OUTSTANDING SHARE DATA

As at the date of this MD&A, the Company had 372,562,749 common shares outstanding and 11,776,300 stock options outstanding under its stock-based incentive plan. As at the same date, the Company had no stock purchase warrants outstanding.

FINANCIAL INSTRUMENTS

The Company classifies financial instruments as financial assets and liabilities at fair value through profit or loss, available-for-sale investments, loans and receivables or financial liabilities at amortized cost. The Company's financial instruments consist of cash and cash equivalents, investments, trade receivables and other, trade payables and accrued liabilities, due to related parties and long-term debt.

The fair value of the Company's investments is derived from quoted prices in active markets for identical assets. The fair value of the Company's long-term debt approximates their carrying amounts due to the fact that there have been no significant changes in the Company's own credit risk. 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 investments.

CONTINGENCIES

Upon completion of the AFD Arrangement Agreement which resulted in the Company holding an undivided 100% ownership interest in the Karowe Mine, the Company retained certain liabilities related to legal proceedings initiated by two former directors of AFD against AFD alleging entitlement to a 3% NSR on production from the Karowe Mine. The claim was heard in the Botswana High Court in early June, 2011. The High Court delivered its ruling in August 2011 dismissing the claims against AFD, with costs awarded against the plaintiffs.

In September, the Company was notified that the plaintiffs, in the legal proceedings initiated against AFD, had filed an appeal of the decision of the High Court of Botswana dismissing the plaintiff's claims with costs awarded in favor of AFD. At this stage the Company does not have any further details as to the timing of when the Appeal will be heard.

The Company continues to believe that the claim is without merit as has been determined by the Botswana High Court, and will continue to vigorously defend the claim.

RISKS AND UNCERTAINTIES

The operations of the Company are speculative due to the high risk nature of its business which includes acquisition, financing, exploration, development and operation of diamond properties. Material risk factors and uncertainties, which should be taken into account in assessing the Company's activities, include, but are not necessarily limited to, those set below. Any one or more of these risks and others could have a material adverse effect on the Company.

No operating profit – Need for additional funds – Dilution

The Company has no history of profitable operations and has negative cash flow from operating activities. The Company has no assurance that additional funding will be available to it for further development and exploration of its various mineral projects, when required. Further development and exploration depends upon the Company's ability to obtain financing through equity or debt financing, joint ventures or other means. While the Company has been successful in the past in obtaining financing through the sale of equity securities, there can be no assurance that the Company will be successful in obtaining additional financing in the amount and at the time required and, if available, that it can be obtained on terms satisfactory to the Company. Such means of financing typically results in dilution of a shareholder's interest, either directly as a result of issuing equity securities or indirectly through dilution of an interest in one of the Company's projects.

Failure to obtain equity or debt financing on a timely basis may cause the Company to postpone its exploration and development plans or forfeit rights in some of its projects.

Economic conditions

Unfavorable economic conditions may negatively impact the Company's financial ability. Unfavorable economic conditions could also increase the Company's financing costs, decrease estimated income from prospective mining operations, limit access to capital markets and negatively impact the availability of credit facilities to the Company.

Uncertainties related to mineral resource estimates

There is a degree of uncertainty attributable to the calculation of mineral resources and corresponding grades being mined or dedicated to future production. Until resources are actually mined and processed, the quantity of resources and grades must be considered as estimates only. In addition, the quantity and value of reserves or resources may vary, depending on diamond prices. Any material change in the quantity of resources, grades or stripping ratio may affect the economic viability of the Company's properties. In addition, there is no assurance that recoveries in small-scale laboratory tests will be duplicated in larger-scale tests under on-site conditions, or during production. Determining the economic viability of a diamond project is complicated and involves a number of variables. It involves extensive geostatistical analysis due to the highly variable nature of diamond distribution in kimberlite pipes and the fact that both diamond grade and average diamond value play important roles in determining the viability of any given diamond project. Since no two diamonds are exactly alike, a significant parcel of diamonds is needed to gain confidence levels on diamond size distribution and average diamond value necessary to make any realistic decisions regarding future development.

Diamond prices and marketability

The mining industry, in general, is intensely competitive and there is no assurance that, even if commercial quantities of diamonds are discovered, a profitable market will exist for the sale of diamonds produced. Factors beyond the control of the Company may affect the marketability of any diamonds produced which cannot be accurately predicted, such as market fluctuations, and such other factors as government regulations, including regulations relating to royalties, allowable production, importing and exporting of diamonds and environmental protection, any combination of which may result in the Company not receiving an adequate return on investment capital. Prices received for diamonds produced and sold are also affected by numerous factors beyond the Company's control such as international economic and political trends, global or regional consumption and demand and supply patterns. There is no assurance that the sale price of diamonds produced from any diamond deposit will be such that they can be mined at a profit.

Licenses, permits and approvals

The Company's operations require licenses, permits and approvals from various governmental authorities. The Company believes that it currently holds and is presently complying in all material respects with all necessary licenses and permits under applicable laws and regulations to conduct its current operations. However, such licenses and permits are subject to change in various circumstances and certain permits and approvals are required to be renewed from time to time. Additional permits or permit renewals will need to be obtained in the future. The granting, renewal and continued effectiveness of these permits and approvals are, in most cases, subject to some level of discretion by the applicable regulatory authority. Certain governmental approval and permitting processes are subject to public comment and can be appealed by project opponents, which may result in significant delays or in approvals being withheld or withdrawn.

There can be no guarantee the Company will be able to obtain or maintain all necessary licenses and permits as are required to explore and develop its properties, commence construction or operation of mining facilities and properties under exploration or development or to maintain continued operations that economically justify the cost.

Currency risk

The Company's business is mainly transacted in South African Rand, Botswana Pula, Canadian dollar and U.S. dollar currencies. As a consequence, fluctuations in exchange rates may have a significant effect on the cash flows and operating results of the Company in either a positive or negative direction.

Mining and processing

The Company's business operations are subject to risks and hazards inherent in the mining industry, including, but not limited to, unanticipated variations in grade and other geological problems, water, power, surface conditions, metallurgical and other processing problems, mechanical equipment performance problems, the lack of availability of materials and equipment, the occurrence of accidents, labour force disruptions, force majeure factors, weather conditions any of which can materially and adversely affect among other things production quantities and rates, development, costs and expenditures and production commencement dates.

The Company periodically reviews its life-of-mine planning. Significant changes in the life-of-mine plans can occur as a result of experience obtained in the course of carrying out its mining activities, changes in mining methods and rates, process changes, investments in new equipment and technology, diamond price assumptions and other factors. Based on this analysis, the Company reviews its accounting estimates and in the event of an impairment may be required to write down the carrying value of its mine or development property. This process continues for the economic life of mines in which the Company has an interest.

Environmental and other regulatory requirements

All phases of mining and exploration operations are subject to government regulation including regulations pertaining to environmental protection. Environmental legislation is becoming stricter, with increased fines and penalties for non-compliance, more stringent assessments of proposed projects and heightened responsibility for companies and their officers, directors and employees. Operations at the Company's mines are subject to strict environmental and other regulatory requirements including health and safety requirements.

Foreign operations risk

The Company's current projects are located in Botswana and Lesotho. Each of these countries exposes the Company to risks that may not otherwise be experienced if its operations were domestic. The risks include, but are not limited to, environmental protection, land use, water use, health safety, labor, restrictions on production, price controls, currency remittance and maintenance of mineral tenure and expropriation of property. There is no assurance that future changes in taxes or such regulation in the various jurisdictions in which the Company operates will not adversely affect the Company's operations. Although the operating environments in Botswana and Lesotho are considered favorable compared to those in other developing countries, there are still political risks. These risks include, but are not limited to terrorism, hostage taking, military repression, expropriation, extreme fluctuations in currency exchange rates, high rates of inflation and labor unrest.

Changes in mining or investment policies or shifts in political attitudes may also adversely affect the Company's business.

Mineral exploration and development

The business of exploring for diamonds and mining is highly speculative in nature and involves significant financial and other risks which even careful evaluation, experience and knowledge may not eliminate. There is no certainty that expenditures made or to be made by the Company in exploring and developing diamond properties in which it has an interest will result in the discovery of commercially mineable deposits. Most exploration projects do not result in the discovery of commercially mineable deposits. While discovery of a diamond bearing deposit may result in substantial rewards, few properties which are explored are ultimately developed into producing mines. Major expenses may be required to establish reserves by drilling and to construct mining and processing facilities at a site. There can be no guarantee that exploration programs carried out by the Company will result in the development of profitable mining operations.

Title matters

Any changes in the laws of Botswana or Lesotho relating to mining could have a material adverse effect to the rights and title to the interests held in those countries by the Company. No assurance can be given that applicable governments will not revoke or significantly alter the conditions of applicable exploration and mining authorizations nor that such exploration and mining authorizations will not be challenged or impugned by third parties.

Infrastructure

Exploration, development, mining and processing activities depend on the availability of adequate infrastructure. Reliable roads, bridges, power and water supply are important determinants which affect capital and operating costs. Unusual or infrequent weather phenomena, sabotage, government or other interference in the maintenance of provision of such infrastructure could adversely affect activities and profitability of the Company.

Uninsured risks

The mining business is subject to a number of risks and hazards including, but not limited to, environmental hazards, industrial accidents, labor disputes, encountering unusual or unexpected geologic formations or other geological or grade problems, encountering unanticipated ground or water conditions, cave-ins, pit wall failures, flooding, rock bursts, periodic interruptions due to inclement or hazardous weather conditions and other acts of God. Such risks could result in damage to mineral properties or facilities, personal injury or death, environmental damage, delays in exploration, development or mining, monetary losses and possible legal liability. The Company maintains insurance against certain risks that are associated with its business in amounts that it believes to be reasonable at the current stage of operations. There can be no assurance that such insurance will continue to be available at economically acceptable premiums or will be adequate to cover any future claim.

Competition

The mining industry is intensely competitive in all its phases and the Company competes with other companies that have greater financial resources and technical capacity. Competition could adversely affect the Company's ability to acquire prospective properties in the future.

Current and future legal proceedings

Due to the nature of its business, the Company may be subject to numerous regulatory investigations, claims, lawsuits and other proceedings in the ordinary course of its business. The results of these legal proceedings cannot be predicted with certainty due to the uncertainty inherent in litigation, including the effects of discovery of new evidence or advancement of new legal theories, the difficulty of predicting decisions of judges and juries and the possibility that decisions may be reversed on appeal. There can be no assurance that these matters will not have a material adverse effect on the Company's business.

In April 2010, legal proceedings were initiated against African Diamonds (Plc) ("AFD"), a subsidiary acquired by the Company in 2010, by two former directors of AFD, alleging entitlement to a 3% royalty on production from the Karowe Mine. The claim was heard in the Botswana High Court in early June 2011. The High Court delivered its ruling in August 2011 dismissing the claims against AFD, with costs awarded against the plaintiffs.

In September, the Company was notified that the plaintiffs, in the legal proceedings initiated against AFD, had filed an appeal of the decision of the High Court of Botswana dismissing the plaintiff's claims with costs awarded in favor of AFD. At this stage the Company does not have any further details as to the timing of when the Appeal will be heard.

Conflicts of interest

The Company's directors and officers may serve as directors or officers, or may be associated with other public companies or have significant shareholdings in other public companies. To the extent that such other companies may participate in business or asset acquisitions, dispositions or ventures in which the Company may participate, the directors and officers of the Company may have a conflict of interest in negotiating and concluding terms respecting the transactions. If a conflict of interest arises, the Company will rely on its code of ethics policy and applicable corporate legislation to which all directors and officers are subject.

These provisions state that where a director has such a conflict, that director must, at a meeting of the Company's directors, disclose his interest and refrain from voting. In accordance with the laws of the Province of British Columbia, the directors and officers of the Company are required to act honestly, in good faith and in the best interests of the Company.

Key personnel

The Company is dependent on a relatively small number of key employees, the loss of any of whom could have an adverse effect on the Company. The Company does not have key person insurance on these individuals.

Share price volatility

In recent years, the securities markets have experienced a high level of price and volume volatility, and the market price of securities of many companies, particularly those considered to be development stage companies, have experienced wide fluctuations which have not necessarily been related to the operating performance, underlying asset values or prospects of such companies. There can be no assurance that such fluctuations will not affect the price of the Company's securities.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements.

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 achieved.

Forward looking statements are based on the opinions 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. 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. In particular, this MD&A may contain forward looking information pertaining to the following: the estimates of the Company's mineral reserve and resources; estimates of the Company's production and sales volumes for the Karowe Mine; estimated costs to construct the Karowe 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 rate; expectations regarding the need to raise capital; possible impacts of disputes or litigation and other risks and uncertainties describe under Risks and Uncertainties disclosed in the Company's Annual Information Form.

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 "Risk Factors' in the Company's Annual Information Form dated April 15, 2011 available at http://www.sedar.com, 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 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), 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.

Management's Report

The accompanying consolidated financial statements of Lucara Diamond Corp. and other information contained in the management's discussion and analysis are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements have been prepared by management in accordance with International financial reporting standards, and include some amounts that are based on management's estimates and judgment.

The Board of Directors carries out its responsibility for the consolidated financial statements principally through its Audit Committee, which is comprised solely of independent directors. The Audit Committee reviews the Company's annual consolidated financial statements and recommends their approval to the Board of Directors. The Company's auditors have full access to the Audit Committee, with and without management being present. These consolidated financial statements have been audited by PricewaterhouseCoopers LLP, Chartered Accountants.

(Signed) William Lamb
President and Chief Executive Officer

(Signed) Glenn Kondo
Chief Financial Officer

Vancouver, British Columbia, Canada
March 22, 2012

March 22, 2012

Independent Auditor's Report

To the Shareholders of Lucara Diamond Corp.

We have audited the accompanying consolidated financial statements of Lucara Diamond Corp., which comprise the consolidated balance sheets as at December 31, 2011, December 31, 2010 and January 1, 2010 and the consolidated statements of operations, comprehensive loss, cash flows and changes in equity for the years ended December 31, 2011 and December 31, 2010, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, 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.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

PricewaterhouseCoopers LLP, Chartered Accountants
PricewaterhouseCoopers Place, 250 Howe Street, Suite 700, Vancouver, British Columbia, Canada V6C 3S7
T:604 806 7000, F:604 806 7806, www.pwc.com/ca

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Lucara Diamond Corp. as at December 31, 2011, December 31, 2010 and January 1, 2010 and its financial performance and its cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

Signed *PricewaterhouseCoopers LLP*

Chartered Accountants

LUCARA DIAMOND CORP.
CONSOLIDATED BALANCE SHEETS
(All amounts expressed in U.S. Dollars, unless otherwise indicated.)

	December 31, 2011	December 31, 2010	January 1, 2010
ASSETS			
Current assets			
Cash and cash equivalents (Note 21)	$ 48,589,409	$ 32,884,905	$ 49,123,926
Investments	109,020	287,308	306,199
Loans receivable	-	-	2,000,000
VAT receivables and other (Note 6)	6,298,262	1,542,948	298,665
Rough diamond inventories	1,597,255	3,964,835	1,943,808
	56,593,946	38,679,996	53,672,598
Plant and equipment (Note 7)	94,501,245	17,492,039	1,681,910
Mineral properties (Note 8)	90,042,677	89,154,742	82,283,912
Other non-current assets	149,513	206,305	-
TOTAL ASSETS	$ 241,287,381	$ 145,533,082	137,638,420
LIABILITIES			
Current liabilities			
Trade payables and accrued liabilities (Note 21)	$ 16,635,832	$ 7,284,929	$ 1,170,409
Due to related parties (Note 19)	-	167,147	113,287
Current portion of long-term debt (Note 9)	10,950,493	-	-
	27,586,325	7,452,076	1,283,696
Due to related parties	-	-	9,863,306
Long-term debt (Note 9)	30,864,165	-	-
Restoration provisions (Note 10)	12,485,650	567,697	360,641
TOTAL LIABILITIES	70,936,140	8,019,773	11,507,643
EQUITY			
Share capital (Note 11)	278,995,472	209,210,999	122,476,675
Contributed surplus (Note 12)	5,769,245	5,421,258	1,649,157
Cumulative deficit	(104,243,885)	(84,121,453)	(13,394,287)
Accumulated other comprehensive income (loss)	(13,200,175)	5,141,321	255,190
Total equity attributable to shareholders of the Company	167,320,657	135,652,125	110,986,735
Non-controlling interests (Note 13)	3,030,584	1,861,184	15,144,042
TOTAL EQUITY	170,351,241	137,513,309	126,130,777
TOTAL LIABILITIES AND EQUITY	$ 241,287,381	$ 145,533,082	137,638,420

Commitments (Note 23), contingencies (Note 24) and subsequent events (Note 25)

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

Approved on Behalf of the Board of Directors:

"Paul K. Conibear"
Director

"William Lamb"
Director

LUCARA DIAMOND CORP.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31
(All amounts expressed in U.S. Dollars, unless otherwise indicated.)

		2011		2010
Exploration expenditures (Note 14)	$	6,618,233	$	11,578,718
Administration (Note 15)		8,182,622		4,455,697
Gain on sale of diamonds (Note 16)		(2,339,282)		-
Loss before the following		12,461,573		16,034,415
Finance income		(963,308)		(454,750)
Finance expenses		2,817,836		38,679
Foreign exchange loss		4,357,791		12,888
Net loss for the year	$	18,673,892	$	15,631,232
Attributable to:				
Shareholders of the Company	$	18,126,567	$	13,309,889
Non-controlling interests	$	547,325	$	2,321,343
Basic and diluted loss per common share (Note 18)	$	0.05	$	0.06
Weighted average common shares outstanding (Note 18)		360,019,710		223,734,936

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

LUCARA DIAMOND CORP.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
FOR THE YEARS ENDED DECEMBER 31
(All amounts expressed in U.S. Dollars, unless otherwise indicated.)

		2011		2010
Net loss for the year	$	18,673,892	$	15,631,232
Other comprehensive loss (income)				
Change in fair value of available-for-sale securities		181,725		18,891
Currency translation adjustment		18,438,911		(5,210,969)
		18,620,636		(5,192,078)
Comprehensive loss	$	37,294,528	$	10,439,154
Comprehensive loss attributable to:				
Shareholders of the Company		36,468,063		8,423,758
Non-controlling interests		826,465		2,015,396
	$	37,294,528	$	10,439,154

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

		2011		2010
Cash flows from (used in):				
Operating Activities				
Net loss for the year	$	(18,673,892)	$	(15,631,232)
Items not involving cash and cash equivalents:				
Depreciation		2,641,443		1,395,815
Foreign exchange loss		918,727		-
Stock-based compensation		609,705		1,085,784
Other		6,547		-
Finance costs		2,817,836		-
Interest receivable		-		(186,066)
		(11,679,634)		(13,335,699)
Net changes in working capital items:				
Trade receivables and other current assets		(4,059,412)		(1,246,567)
Rough diamond inventories		2,544,063		(1,865,201)
Trade payables and other current liabilities		(388,931)		1,212,881
		(13,583,914)		(15,234,586)
Financing Activities				
Proceeds from issue of shares, net of issue costs		58,283,612		587,624
Proceeds from long-term debt		50,000,000		-
Finance costs paid		(1,484,536)		-
Proceeds from exercise of stock options		575,900		7,356,256
Proceeds from non-controlling interest		-		2,808,825
		107,374,976		10,752,705
Investing Activities				
Acquisition of plant and equipment		(77,191,407)		(11,372,878)
Other		23,576		-
Acquisition of other assets		-		(206,305)
Cash paid in acquisition		-		(1,224,163)
		(77,167,831)		(12,803,346)
Effect of exchange rate change on cash and cash equivalents		(918,727)		1,046,206
Increase (decrease) in cash and cash equivalents during the year		15,704,504		(16,239,021)
Cash and cash equivalents, beginning of year		32,884,905		49,123,926
Cash and cash equivalents, end of year	$	48,589,409	$	32,884,905
Supplemental Information				
Interest received		963,308		268,684
Taxes paid		-		-
Changes in accounts payable and accrued liabilities related to plant and equipment		11,409,099		4,955,499
Common shares issued for debenture (Note 11)		10,663,220		-

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 U.S. Dollars, unless otherwise indicated.)

	Number of shares issued and outstanding	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive income (loss)	Non-controlling interests	Total
Balance, January 1, 2010	208,768,167	$ 122,476,675	$ 1,649,157	$ (13,394,287)	$ 255,190	$ 15,144,042	$ 126,130,777
Shares issued, net of guarantee fees	12,191,200	9,863,306	-	-	-	-	9,863,306
Shares issued for acquisition of African Diamonds	80,425,726	76,127,684	1,575,193	(59,544,195)	-	(21,568,911)	(3,410,229)
Proceeds from non-controlling interests	-	-	-	-	-	2,808,825	2,808,825
Disposition of non-controlling interests	-	-	-	2,126,918	-	5,229,338	7,356,256
Stock based payment	-	-	1,266,834	-	-	2,263,286	3,530,120
Exercise of stock options	1,108,957	743,334	(155,710)	-	-	-	587,624
Stock-based compensation	-	-	1,085,784	-	-	-	1,085,784
Unrealized loss on investments	-	-	-	-	(18,891)	-	(18,891)
Effect of foreign currency translation	-	-	-	-	4,905,022	305,947	5,210,969
Net loss for the year	-	-	-	(13,309,889)	-	(2,321,343)	(15,631,232)
Balance, December 31, 2010	302,494,050	$ 209,210,999	$ 5,421,258	$ (84,121,453)	$ 5,141,321	$ 1,861,184	$ 137,513,309
Balance, January 1, 2011	302,494,050	$ 209,210,999	$ 5,421,258	$ (84,121,453)	$ 5,141,321	$ 1,861,184	$ 137,513,309
Private placement, net of share issue costs	60,000,000	58,283,612	-	-	-	-	58,283,612
Shares issued in lieu of interest and fees (Note 8)	9,000,000	10,663,220	-	-	-	-	10,663,220
Exercise of stock options	854,999	837,641	(261,718)	-		-	575,923
Stock-based compensation	-	-	609,705	-	-	-	609,705
Effect of foreign currency translation	-	-	-	-	(18,159,771)	(279,140)	(18,438,911)
Unrealized loss on investments	-	-	-	-	(181,725)	-	(181,725)
Free-carried non-controlling interests (Note 13)				(1,995,865)	-	1,995,865	-
Net loss for the year	-	-	-	(18,126,567)	-	(547,325)	(18,673,892)
Balance, December 31, 2011	372,349,049	$ 278,995,472	$ 5,769,245	$ (104,243,885)	$ (13,200,175)	$ 3,030,584	$ 170,351,241

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 development stage company focused on diamond properties in Africa. The Company holds a 100% interest in the Karowe Mine (previously named AK6 Diamond Project) located in Botswana and a 75% interest in Mothae Diamond Project located in Lesotho.

The Company's common shares are listed on the TSX, NASDAQ OMX First North 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 2610 - 1066 West Hastings Street, Vancouver, British Columbia, V6C 3E8.

2. BASIS OF PRESENTATION AND ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

The Company prepared its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants (CICA Handbook). In 2010, the CICA Handbook was revised to incorporate IFRS as issued by the International Accounting Standards Board ("IASB") and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, these are the Company's first annual consolidated financial statements prepared in accordance with IFRS as issued by the IASB. In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These consolidated financial statements have been prepared in compliance with IFRS. Subject to certain transition elections disclosed in Note 5, the Company has consistently applied the accounting policies used in its opening IFRS balance sheet at January 1, 2010 throughout all periods presented, as if these policies had always been in effect. Note 5 discloses the impact of the transition to IFRS on the Company's reported balance sheet, results of operations and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010.

These financial statements were approved by the Board of Directors for issue on March 22, 2012.

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.

Certain comparative figures have been reclassified to conform to the presentation adopted for the current year.

(b) Consolidation

These consolidated financial statements include the accounts of the Company and all of its subsidiaries. The Company's significant subsidiaries include, Motapa Diamonds Inc., Motapa Exploration Limited, Kavango Diamond Company (Pty) Ltd, Lucara Diamond Holdings (I) Inc., Boteti Diamond Holdings Inc., Boteti Mining (PTY) Ltd, Mothae Diamond Holdings Inc., African Diamonds (Plc), Lucara South Africa (PTY) (formerly Gondwana Diamonds (PTY)) and its 75% interest in Mothae Diamond Proprietary Limited.

Subsidiaries are entities controlled by the Company. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. 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 recognized non-controlling interests. All intercompany balances, transactions, income, expenses, profits and losses, including unrealized gains and losses have been eliminated on consolidation. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

Non-controlling interests represent the equity in a subsidiary not attributable, directly and indirectly, to the Company and is presented separately within equity in the consolidated balance sheet, separately from equity attributable to the shareholders of the Company. Losses within a subsidiary continue to be attributed to the non-controlling interests even if that results in a deficit balance. Changes in the Company's ownership interest in subsidiaries that do not result in a loss of control are accounted for as equity transactions.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(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:

Valuation of mineral properties – The Company carries the acquisition costs of its mineral properties at cost less any provision for impairment. The Company undertakes a periodic review of the carrying values of mineral properties and 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.

Utilization of tax losses – The Company is subject to income taxes in a number of jurisdictions. At present all of the entities are making tax losses. These tax losses are only recognized to the extent that expected future taxable profits are available.

Stock based compensation – The fair value of stock options is determined using the Black-Scholes option pricing model and are expensed over their vesting periods. In estimating fair value, management of the Company is required to make certain assumptions and estimates regarding the life of the options, volatility and forfeitures rates. Changes in the assumptions used could result in materially different results.

Decommissioning and site restoration – The Company has obligations for site restoration and decommissioning related to its diamond properties. 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 countries in which the mines operate, 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 operating costs. Actual results could differ from estimates made by management during the preparation of these consolidated financial statements and those differences may be material.

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 diamond projects, being the Karowe Mine and the Mothae Diamond Project and Corporate. The Corporate office provides support to the diamond projects with respect to treasury and finance, technical support, regulatory reporting and corporate administration.

(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 significant subsidiaries of the Company are Boteti Mining (PTY) Ltd., which has a Pula functional currency and Mothae Diamonds (Pty) Ltd, which has a Loti functional currency. 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 for each statement of operation 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(f) Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

(g) Financial instruments

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.

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

(i) Financial assets and liabilities at 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. Non-derivative financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the balance sheet date, which are classified as non-current.

(ii) Available-for-sale investments: Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from remeasurement are recognized in other comprehensive income except for exchange gains and losses on the translation of debt securities, which are recognized in the consolidated statement of operations. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of operations and are included in "other gains and losses". Available-for-sale investments are classified as non-current, unless an investment matures within twelve months, or management expects to dispose of it within twelve months.

Interest on available-for-sale debt instruments, calculated using the effective interest method, is recognized in the statement of operations as part of interest income. Dividends on available-for-sale equity instruments are recognized in the statement of operations as dividend income when the Company's right to receive payment is established.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(iii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables comprise cash and cash equivalents and trade receivables and are included in current assets due to their short-term nature. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

(iv) Financial liabilities at amortized cost: Financial liabilities at amortized cost include trade payables, bank debt and long-term debt. Trade payables are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are measured at amortized cost using the effective interest method. Bank debt and long-term debt are recognized initially at fair value, net of any transaction costs incurred and subsequently at amortized cost using the effective interest method. These are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

Impairment of financial assets

At each reporting date, the Company assesses whether there is objective evidence that a financial asset (other than a financial asset classified as fair value through profit or loss) is impaired.

The criteria used to determine if objective evidence of an impairment loss exists include:

(i) significant financial difficulty of the obligor;
(ii) delinquencies in interest or principal payments; and
(iii) it becomes probable that the borrower will enter bankruptcy or other financial reorganization.

For equity securities, a significant or prolonged decline in the fair value of the security below its cost is also evidence that the assets are impaired.

If such evidence exists, the Company recognizes an impairment loss, as follows:

(i) Financial assets carried at amortized cost: The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

(ii) Available-for-sale financial assets: The impairment loss is the difference between the original cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the statement of operations. This amount represents the loss in accumulated other comprehensive income that is reclassified to net loss.

Impairment losses on financial assets carried at amortized cost and available-for-sale debt instruments are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized. Impairment losses on available-for-sale equity instruments are not reversed.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(h) Inventories

Rough diamond inventories are measured at the lower of cost and net realizable value. 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.

(i) Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation 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.

Depreciation 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
Plant facilities	based on resources 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(j) Exploration and evaluation expenditures and mineral properties

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 requirement

Exploration and development expenditures are expensed as incurred on mineral properties not sufficiently advanced as to identify their development potential. 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. Costs associated with acquiring a mineral property are capitalized as incurred.

(k) Intangible assets

Intangible assets are initially recognized at cost and measured subsequently at cost less accumulated amortization and impairment losses. Finite-lived intangible assets are amortized based on resources over a unit of production basis.

(l) Impairment of non-financial assets

Assets that are subject to amortization are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. 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 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.

(m) 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 credit adjusted 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 credit adjusted 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)

Environmental expenditures

Environmental expenditures that relate to current operations are expensed or capitalized as appropriate. Expenditures that relate to an existing condition caused by past operations and which do not contribute to current or future revenue generation are expensed. Liabilities are recorded when environmental assessments and/or remedial efforts are probable, and the costs can be reasonably estimated.

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.

(n) Deferred income taxes

Deferred tax is 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 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(o) 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.

(p) Stock-based compensation

The Company has a stock-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 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 options 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.

(q) Loss per share

Loss per share is calculated by dividing the loss attributable to the shareholders of the Company by the weighted average number of common shares issued and outstanding during the year. Diluted loss per share is calculated using the treasury stock method. The effects of potential issuance of shares under options would be anti-dilutive, and therefore, basic and diluted loss per share are the same.

(r) Leases

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.

(s) 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. ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET ADOPTED

Unless otherwise noted, the following revised standards and amendments are effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. The Company has not yet assessed the impact of these standards and amendments or determined whether it will early adopt them.

a) IFRS 9, *Financial Instruments,* was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, *Financial Instruments – Recognition and Measurement,* except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income. IFRS 9 was amended further in December 2011 and is now mandatory in 2015.

b) IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces *SIC-12, Consolidation—Special Purpose Entities* and parts of IAS 27, *Consolidated and Separate Financial Statements*.

c) IFRS 11, Joint Arrangements, requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities—Non-monetary Contributions by Venturers*.

d) IFRS 12, *Disclosure of Interests in Other Entities*, establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosure that address the nature of, and risks associated with, an entity's interests in other entities.

4. ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET ADOPTED (continued)

e) IFRS 13, *Fair Value Measurement*, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures.

f) There have been amendments to existing standards, including IAS 27, *Separate Financial Statements* (IAS 27), and IAS 28, *Investments in Associates and Joint Ventures* (IAS 28). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

g) IAS 19, *Employee Benefits*, has been amended to make significant changes to the recognition and measurement of defined benefit pension expense and termination benefits and to enhance the disclosure of all employee benefits. The amended standard requires immediate recognition of actuarial gains and losses in other comprehensive income as they arise, without subsequent recycling to net income. Past service cost (which will now include curtailment gains and losses) will no longer be recognized over a service period but instead will be recognized immediately in the period of a plan amendment. Pension benefit cost will be split between (i) the cost of benefits accrued in the current period (service cost) and benefit changes (past-service cost, settlements and curtailments); and (ii) finance expense or income. The finance expense or income component will be calculated based on the net defined benefit asset or liability. A number of other amendments have been made to recognition, measurement and classification including redefining short-term and other long-term benefits, guidance on the treatment taxes related to benefit plans, guidance on risk/cost sharing features, and expanded disclosures.

h) IAS 1, *Presentation of Financial Statements*, has been amended to require entities to separate items presented in OCI into two groups, based on whether or not items may be recycled in the future. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately. The amendment is effective for annual periods beginning on or after July 1, 2012 with earlier application permitted.

5. ADJUSTMENT AND TRANSITION TO IFRS

a) Adjustment of equity transfer to the Government of Lesotho ("GOL")

During the year ended December 31, 2011, the Company re-evaluated its accounting for the transfer of shares and a share option in Mothae Diamond Proprietary Limited ("Mothae") to the GOL during 2010. Previously, the Company had accounted for the transfer as an expropriation for no proceeds. The Company, after further review, has now concluded that it made a stock based payment in exchange for a mining license, which is capitalized as an intangible asset. The Company has made the following adjustments, as at and for the year ended December 31, 2010:

- Increased mineral property costs by $3,530,120, representing the fair value of the intangible mining rights received from the GOL as based upon the fair value as of June 2010 of the shares and share option in Mothae;

- Increased non-controlling interest ("NCI") by $2,263,286, representing the fair value of the 12.5% "free-carried" interest in Mothae transferred to the GOL as of June 2010;

- Increased contributed surplus by $1,266,834, representing the fair value, as of June 2010, of the GOL's option on the additional 12.5% interest in Mothae, which will beneficially transfer to the GOL upon their full payment for these shares. These shares are to be paid for by the GOL on a contingent basis, such that they are payable only from the first $1.825 million of dividends on these shares. Management has fair valued the option on these shares by using the fair value established for the NCI portion above and deducting the fair value of the $1.825 million, discounted at 10% per annum for a period of approximately 6 years until the cash flows from Mothae are estimated to be sufficient to cover the required payment; and

- Decreased the NCI by $708,049 representing the NCI share of losses of Mothae from the date of the related Shareholder Agreement, June 23, 2010 whereby the GOL received its 12.5% free-carried interest to December 31, 2010. The increased allocation of the losses of Mothae for the year ended December 31, 2010 result in an equivalent decrease in the loss attributable to the shareholders of the Company for the year and to the deficit at December 31, 2010.

The option on the 12.5% interest, which has been treated as contributed surplus, will continue to be treated as contributed surplus and no attribution of the income or losses of Mothae will be recorded until the shares have been paid for by way of future dividends. At that time the amount will be transferred from contributed surplus to NCI and the future NCI attribution will be based on 25%.

Management has deemed the magnitude of the adjustment to not be material and accordingly, has determined that a restatement of the December 31, 2010 consolidated financial statements is not warranted.

5. ADJUSTMENT AND TRANSITION TO IFRS (continued)

b) IFRS transition elections

The Company has applied the following transition exceptions and exemptions to the full retrospective application of IFRS as follows:

- Business combinations: In applying this exemption the Company will continue to carry forward its previous GAAP accounting for business combinations prior to the transition date.
- Stock based compensation: In applying this exemption the Company will not be required to apply IFRS 2 to options vested before the transition date.
- Cumulative translation adjustments ("CTA"): In applying this exemption the cumulative translation differences for all foreign operations (subsidiaries, joint ventures and equity method investments) with a functional currency different from the Company's reporting currency (self-sustaining foreign operations under Canadian GAAP) will be deemed to be zero at transition (CTA balances are eliminated with offsetting entry recorded directly to retained earnings).

c) Functional currency and cumulative translation adjustment account

Under Canadian GAAP the Company determines whether a subsidiary is an integrated operation or a self-sustaining entity which determines the method of translation into the presentation currency of the Company. IFRS requires that an entity determine the functional currency of each subsidiary individually, prior to consolidation into the Company's presentation currency.

The Company has determined that the parent company and its significant subsidiaries had functional currencies other than the U.S. dollar, which under Canadian GAAP had been classified as being integrated operations. Those subsidiaries under Canadian GAAP were consolidated using the temporal method (i.e. monetary assets and liabilities translated at the current rate and non-monetary assets and liabilities at historic exchange rates with gains or losses being charged to income), whereas under IFRS those entities with non U.S. dollar functional currencies are translated into U.S. dollars using the current rate method (whereby all assets and liabilities are translated using the reporting date exchange rates with any gains or losses being recorded in equity).

The net impact as at January 1, 2010, was an increase in diamond inventories of $178,848, an increase in plant and equipment of $181,910, an increase in mineral properties of $1,455,884 and an offsetting CTA adjustment of $1,816,642. As permitted by the exemption, the Company added this $1,816,642 adjustment to the Canadian GAAP CTA account of $385,035 as at January 1, 2010 and reset these amounts to nil with the offsetting credit applied to deficit in the amount of $2,201,677.

The net impact as at December 31, 2010 and for the year then ended, was an increase in diamond inventories of $334,674, an increase in plant and equipment of $1,020,798, an increase in mineral properties of $4,696,720, a decrease in foreign exchange loss of $12,658 and an offsetting CTA adjustment of $6,039,534 of which $305,947 relates to non-controlling interests. As previously discussed, $1,816,642 of this adjustment was recorded at January 1, 2010 and the balance represents the CTA adjustment to be recorded on other comprehensive income for the year ended December 31, 2010 in the amount of $4,222,892.

5. ADJUSTMENT AND TRANSITION TO IFRS (continued)

d) *Reversal of deferred income tax liability*

Under Canadian GAAP, the Company was required to record a future income tax liability on prior assets acquisitions and such a purchase price gross up is not permitted under IFRS.

The net impact at January 1, 2010, was a decrease in mineral properties and future income tax liability of $8,051,101.

For the year ended December 31, 2010, the impact was a decrease in mineral properties of $8,051,101, future income tax liability of $5,391,720 and a reversal of unrealized foreign exchange loss of $537,619 and income tax recovery of $3,197,000.

e) *Reclassification of accretion to finance charges*

Under Canadian GAAP, accretion was previously reflected with depreciation and depletion. Pursuant to IFRS accretion has been reclassified to finance expenses.

f) *Statement of cash flows*

The transition from Canadian GAAP to IFRS had no significant impact on cash flows generated by the Company except that, under IFRS, cash flows relating to interest are classified in a consistent manner as operating, investing or financing each period. Under Canadian GAAP, cash flows relating to interest payments were classified as operating.

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

5. ADJUSTMENT AND TRANSITION TO IFRS (continued)

f) Reconciliation of consolidated balance sheets as at January 1, 2010 and December 31, 2010 and the statement of comprehensive income for the year ended December 31, 2010 from Canadian GAAP to IFRS

CONSOLIDATED BALANCE SHEET December 31, 2010	**CDN GAAP**	**Adjustment (Note 5a)**	**Adj #**	**IFRS adjustments**	**IFRS**
ASSETS					
Current assets					
Cash and cash equivalents	$ 32,884,905	$ -		$ -	$ 32,884,905
Investments	287,308	-		-	287,308
Loans receivable	-	-		-	-
Trade receivables and other	1,542,948	-		-	1,542,948
	34,715,161	-		-	34,715,161
Rough diamond inventories	3,630,161	-	(c)	334,674	3,964,835
Plant and equipment	16,471,241	-	(c)	1,020,798	17,492,039
Mineral properties	88,979,003	3,530,120	(c, d)	(3,354,381)	89,154,742
Other non-current assets	206,305	-		-	206,305
TOTAL ASSETS	$ 144,001,871	$ 3,530,120		$ (1,998,909)	$ 145,533,082
LIABILITIES					
Current liabilities					
Trade payables and accrued liabilities	$ 7,284,929	$ -		$ -	$ 7,284,929
Due to related parties	167,147	-		-	167,147
Current portion of long-term debt	-	-		-	-
	7,452,076	-		-	7,452,076
Due to related parties	-	-		-	-
Long-term debt	-	-		-	-
Restoration provisions	567,697	-		-	567,697
Future income taxes	5,391,720	-	(d)	(5,391,720)	-
TOTAL LIABILITIES	13,411,493	-		(5,391,720)	8,019,773
EQUITY ATTRIBUTABLE TO SHAREHOLDERS					
Share capital	209,210,999	-		-	209,210,999
Contributed surplus	4,154,424	1,266,834		-	5,421,258
Cumulative deficit	(84,384,456)	708,049	(c)	(445,046)	(84,121,453)
Accumulated other comprehensive income	1,609,411	-	(d)	3,531,910	5,141,321
Total equity attributable to shareholders of the company	130,590,378	1,974,883		3,086,864	135,652,125
Non-controlling interests	-	1,555,237	(c)	305,947	1,861,184
TOTAL EQUITY	130,590,378	3,530,120		3,392,811	137,513,309
TOTAL LIABILITIES AND EQUITY	$ 144,001,871	$ 3,530,120		$ (1,998,909)	$ 145,533,082

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

5. ADJUSTMENT AND TRANSITION TO IFRS (continued)

CONSOLIDATED STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME

For the year ended December 31, 2010	CDN GAAP	Adjustment (Note 5a)	Adj #	IFRS adjustments	IFRS
Exploration expenditures	$ 11,617,397	-	(e)	$ (38,679)	$ 11,578,718
Administration	4,455,697	-		-	4,455,697
Gain on sale of diamonds	-	-		-	-
Loss (gain) before the following	16,073,094	-		(38,679)	16,034,415
Finance income	(454,750)	-		-	(454,750)
Finance expenses	-	-	(e)	38,679	38,679
Foreign exchange loss (gain)	563,165	-	(d)	(550,277)	12,888
Loss (income) before income taxes	16,181,509	-		(550,277)	15,631,232
Income taxes	(3,197,000)	-	(d)	3,197,000	-
Net loss	$ 12,984,509	-		$ 2,646,723	$ 15,631,232
Other comprehensive income in the year					
Change in fair value of available-for-sale securities	18,891	-		-	18,891
Currency translation adjustment	(988,077)	-	(c)	(4,222,892)	(5,210,969)
	(969,186)	-		(4,222,892)	(5,192,078)
Comprehensive loss (income)	$ 12,015,323	$ -		$ (1,576,169)	$ 10,439,154
Net loss attributable to:					
Shareholders of the Company	11,371,215	(708,049)	(c)	2,646,723	13,309,889
Non-controlling interests	1,613,294	708,049		-	2,321,343
	$ 12,984,509	$ -		$ 2,646,723	$ 15,631,232
Comprehensive loss (income) attributable to:					
Shareholders of the Company	10,402,029	(708,049)	(c, d)	(1,270,222)	8,423,758
Non-controlling interests	1,613,294	708,049	(d)	(305,947)	2,015,396
	$ 12,015,323	$ -		$ (1,576,169)	$ 10,439,154

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

5. ADJUSTMENT AND TRANSITION TO IFRS (continued)

CONSOLIDATED BALANCE SHEET January 1, 2010	**CDN GAAP**	**Adj #**	**IFRS adjustments**	**IFRS**
ASSETS				
Current assets				
Cash and cash equivalents	$ 49,123,926		$ -	$ 49,123,926
Investments	306,199		-	306,199
Loans receivable	2,000,000		-	2,000,000
Trade receivables and other	298,665		-	298,665
	51,728,790		-	51,728,790
Rough diamond inventories	1,764,960	(c)	178,848	1,943,808
Plant and equipment	1,500,000	(c)	181,910	1,681,910
Mineral properties	88,879,129	(d)	(6,595,217)	82,283,912
Other non-current assets	-		-	-
TOTAL ASSETS	$ 143,872,879		$ (6,234,459)	$ 137,638,420
LIABILITIES				
Current liabilities				
Trade payables and accrued liabilities	$ 1,170,409		$ -	$ 1,170,409
Due to related parties	113,287		-	113,287
Current portion of long-term debt	-		-	-
	1,283,696		-	1,283,696
Due to related parties	9,863,306		-	9,863,306
Long-term debt	-		-	-
Restoration provisions	360,641		-	360,641
Future income taxes	8,051,101	(d)	(8,051,101)	-
TOTAL LIABILITIES	19,558,744		(8,051,101)	11,507,643
EQUITY ATTRIBUTABLE TO SHAREHOLDERS				
Share capital	122,476,675		-	122,476,675
Contributed surplus	1,649,157		-	1,649,157
Cumulative deficit	(15,595,964)	(c)	2,201,677	(13,394,287)
Accumulated other comprehensive income (loss)	640,225	(d)	(385,035)	255,190
Total equity attributable to shareholders of the company	109,170,093		1,816,642	110,986,735
Non-controlling interests	15,144,042		-	15,144,042
TOTAL EQUITY	124,314,135		1,816,642	126,130,777
TOTAL LIABILITIES AND EQUITY	$ 143,872,879		$ (6,234,459)	$ 137,638,420

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

6. VAT RECEIVABLES AND OTHER

	2011	2010
VAT	$ 5,933,746	$ 1,430,894
Other	149,497	56,040
Prepayments	215,019	56,014
	$ 6,298,262	$ 1,542,948

7. PLANT AND EQUIPMENT

Cost	Construction in progress	Mine and plant facilities	Vehicles	Furniture and office equipment	Total
Balance, January 1, 2010	$ -	$ 1,681,910	$ -	$ -	$ 1,681,910
Additions	10,935,766	4,458,906	424,576	267,815	16,087,063
Disposals and other	-	-	-	-	-
Translation differences	559,258	659,823	30,535	20,386	1,270,002
Balance, December 31, 2010	11,495,024	6,800,639	455,111	288,201	19,038,975
Additions	84,164,797	2,412,460	1,017,022	2,268,944	89,863,223
Disposals and other	-	-	-	(8,103)	(8,103)
Translation differences	(8,939,809)	(1,447,211)	(158,333)	(230,021)	(10,775,374)
Balance, December 31, 2011	$ 86,720,012	$ 7,765,888	$ 1,313,800	$ 2,319,021	$ 98,118,721

Accumulated depreciation					
Balance, January 1, 2010	$ -	$ -	$ -	$ -	$ -
Depreciation, depletion for the year	-	1,333,977	1,960	21,199	1,357,136
Disposals and other	-	-	-	-	-
Translation differences	-	186,561	274	2,965	189,800
Balance, December 31, 2010	-	1,520,538	2,234	24,164	1,546,936
Depreciation, depletion for the year	-	2,165,316	309,721	166,407	2,641,444
Disposals and other	-	-	-	(690)	(690)
Translation differences	-	(521,490)	(29,572)	(19,152)	(570,214)
Balance, December 31, 2011	$ -	$ 3,164,364	$ 282,383	$ 170,729	$ 3,617,476

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

7. PLANT AND EQUIPMENT (continued)

Net book value					
As at January 1, 2010	$ -	$ 1,681,910	$ -	$ -	$ 1,681,910
As at December 31, 2010	$ 11,495,024	$ 5,280,101	$ 452,877	$ 264,037	$ 17,492,039
As at December 31, 2011	$ 86,720,012	$ 4,601,524	$ 1,031,417	$ 2,148,292	$ 94,501,245

Plant and equipment include interest and financing costs relating to the construction of plant and equipment prior to the commencement of commercial production. Interest and financing costs are capitalized only for the project for which funds have been borrowed. Interest expense capitalized in 2011 was $1,262,717 (2010 - nil).

8. MINERAL PROPERTIES

Cost	Karowe Mine	Karowe restoration asset	Mothae Diamond	Mothae mining license	Total
Balance, January 1, 2010	$ 63,718,210	$ -	$ 18,565,702	$ -	$ 82,283,912
Additions	-	-	99,874	3,530,120	3,629,994
Disposals and other	-	-	-	-	-
Translation differences	892,049	-	1,817,922	530,865	3,240,836
Balance, December 31, 2010	64,610,259	-	20,483,498	4,060,985	89,154,742
Additions	-	12,959,168	187,518	-	13,146,686
Disposals and other	-	-	-	-	-
Translation differences	(7,901,090)	(1,166,060)	(2,445,156)	(746,445)	(12,258,751)
Balance, December 31, 2011	$ 56,709,169	$ 11,793,108	$ 18,225,860	$ 3,314,540	$ 90,042,677

a) *Karowe Mine*

In December 2009, the Company, through a newly created indirect wholly-owned subsidiary Boteti Diamond Holdings Inc. ("Boteti Holdings"), acquired an initial 70.268% interest in the Boteti Mining (PTY) Ltd. ("Boteti"), from De Beers Prospecting Botswana (Pty) Limited ("De Beers"), for consideration of $49 million. The remaining interest in Boteti was held as to 28.381% by African Diamonds PLC ("African Diamonds") and indirectly by Wati Ventures (Pty) Ltd. ("Wati Ventures") as to 1.351%.

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

8. MINERAL PROPERTIES (continued)

To fund the Karowe Mine acquisition, Lucara and Boteti Holdings had entered into a guarantee and loan facility with a significant shareholder of the Company in the amount of $49.0 million. As consideration for the guarantee, the lender was entitled to receive 12,191,200 shares in the Company. The shares were issued in 2010 at a fair value of $9.8 million.

The net assets acquired on the acquisition of Boteti did not meet the definition of a business; accordingly, the acquisition had been accounted for as a purchase of assets and liabilities. The purchase price allocation is summarized as follows:

Purchase price:	
Cash paid	$49,000,000
Transaction costs	623,292
	$49,623,992
Net assets acquired	
Cash and cash equivalents	$ 1,166,738
Accounts receivable and prepaid expenses	67,441
Diamond inventory	235,023
Mineral properties	68,329,697
Accounts payable and accrued liabilities	(419,336)
Future income tax liability	(4,611,528)
Minority interest	(15,144,043)
	$49,623,992

The purchase price has been allocated to the fair value of the assets acquired and liabilities assumed, based on management's best estimates and taking into account all available information at the time of acquisition.

Boteti Holdings had granted an option to African Diamonds to increase its interest in Boteti by a further 10.268% by making a cash payment of approximately US$7.3 million, which was exercised in April 2010. The value of the non-controlling interest in Boteti that was disposed of was $5,229,338. This transaction has been accounted for as an equity transaction. The $2,126,918 received in excess of the non-controlling interest has been recorded as an adjustment to the deficit in the year ended December 31, 2010. After the exercise of the option, Boteti was held 60% by the Company and 40% by African Diamonds. In December 2010, the Company acquired the 40% non-controlling interest.

8. MINERAL PROPERTIES (continued)

b) Mothae Diamond Project

In July 2006, the Company signed an option agreement with Motapa Diamonds Inc. ("Motapa") to acquire up to a 70% interest in the Mothae Diamond Project located in Lesotho, Africa. Pursuant to the terms of the option agreement the Company earned a 65% interest in the property in April 2009 by making payments to Motapa totaling $8.0 million.

On July 3, 2009, the Company acquired the remaining 35% interest in the property by acquiring Motapa through a plan of arrangement by issuing a total of 34,455,022 shares to the shareholders of Motapa at an exchange ratio of 0.9055 shares ("Exchange Ratio") for each Motapa share. In addition, the Company issued a total of 3,019,835 replacement stock options to the Motapa stock option holders at the same exchange ratio.

Pursuant to the terms of the mining agreement, Mothae Diamonds, an indirect 75% owned subsidiary of the Company has a 100% interest in the project. The remaining 25% of Mothae Diamonds is held by the Government of Lesotho. One half of the project interest held by the Government is a free carried interest and one half is funded by the Government through its share of project dividends. During an initial pre-production test mining stage, a royalty of 4% of the sales value of diamonds produced from Mothae will be payable to the government. At full production the royalty will increase to 8% of diamond sales value. The mining lease is valid until September 2019 and renewable for an additional 10 years.

In terms of IFRS 2 – Share-based payments, the granting of this equity stake classifies the transaction as a share-based payment, as the entity is obtaining the right to mine the kimberlite pipe in exchange for equity in the entity. The mining lease provides for the ultimate transfer of a 25% equity interest in the entity and makes no provisions for cash settlement. As such, the share-based payment was treated and recognized as an equity settled share-based payment.

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

9. LONG-TERM DEBT

In July 2011, the Company entered into a $50 million loan agreement secured by a debenture to fund the development of the Company's projects. The loan facility has a maturity date of December 31, 2013 and requires quarterly repayments of $8.3 million commencing September 30, 2012. No interest is payable during the term of the facility. The facility is secured by a pledge by the Company of the shares of the subsidiaries that control the companies that own the projects. The facility has been issued by Zebra Holdings and Investments S.a.r.l ("Zebra") and Lorito Holdings S.a.r.l ("Lorito"), each an investment company owned by a trust settled by the late Adolf H. Lundin, and not a related party of the Company.

The terms of the debenture financing also included the Company issuing an aggregate of 9 million common shares (fair value $10.7 million) to Zebra and Lorito as consideration for the facility, in lieu of interest and fees. During the year, accretion of $2.6 million was recorded of which $1.3 million has been capitalized in plant and equipment (Note 7).

The borrowings have been measured at fair value. The liability is measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

As at December 31, 2011	Current portion	Long-term portion	Total
Principal	$ 16,666,666	$ 33,333,334	$ 50,000,000
Unamortized discount	(5,716,173)	(2,469,169)	(8,185,342)
Total carrying value	$ 10,950,493	$ 30,864,165	$ 41,814,658

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

10. RESTORATION PROVISIONS

The Company's restoration provisions relate to the rehabilitation of its diamond mine properties. 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 10% at December 31, 2011 and an inflation rate of 6% at December 31, 2011 at the Karowe Mine project. The Company has applied a pre-tax discount rate of 11.0% at December 31, 2011 (10.5% at December 31, 2010) and an inflation rate of 6.0% at December 31, 2011 (6.4% at December 31, 2010) at its Mothae Diamond Project. The rehabilitation costs are expected to be incurred in the period of 2022 to 2024. The estimated total liability for reclamation and remediation costs on an undiscounted basis after inflation is approximately $17.5 million (December 31, 2010 - $3.2 million, December 31, 2009 - $1.7 million).

		2011		2010
Balance, beginning of year	$	567,697	$	360,641
Settlement of obligations during the year		-		-
Fair value of obligation recorded during the year		12,959,168		99,874
Revisions to estimated cash flows		187,518		-
Accretion of liability component of obligation		70,583		38,679
Foreign currency translation adjustment		(1,299,316)		68,503
Balance, end of year		12,485,650		567,697
Less: Current portion		-		-
Long-term portion of restoration provisions	$	12,485,650	$	567,697

11. SHARE CAPITAL

The authorized share capital consists of an unlimited number of common shares, with no par value.

In February 2011, the Company completed a private placement of 60,000,000 common shares at price of CAD$1.00 per share of gross proceeds of CAD$60.0 million. A fee of 5% was paid on a portion of the private placement.

In July 2011, 9.0 million common shares with a fair value of $10.7 million were issued in lieu of interest and fees to Zebra and Lorito as part of the issuance of the $50.0 million debenture (Note 9).

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

12. STOCK OPTIONS

The Company has one rolling stock option plan (the "Plan") approved by the shareholders of the Company on May 13, 2011 which reserves an aggregate of 10% of the issued and outstanding shares of the Company for issuance upon the exercise of options granted. Vesting and terms of the option agreement are at the discretion of the Board of Directors.

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 (CDN$)
Balance at December 31, 2009	**5,704,782**	**$ 0.76**
Granted	7,840,000	0.95
Forfeited	(885,825)	0.77
Expired	-	-
Exercised	(1,108,957)	0.56
Balance at December 31, 2010	**11,550,000**	**0.91**
Granted	1,525,000	0.84
Forfeited	(168,330)	0.95
Expired	(20,000)	0.77
Exercised	(854,999)	0.71
Balance at December 31, 2011	**12,031,671**	**$ 0.93**

Options to acquire common shares have been granted and are outstanding at December 31, 2011 as follows:

	Outstanding Options			**Exercisable Options**		
Range of exercise prices CDN$	Number of options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price CDN$	Number of options exercisable	Weighted average remaining contractual life (years)	Weighted average exercise price CDN$
$0.00 - $0.49	1,515,010	0.52	$ 0.48	1,515,010	0.52	$ 0.48
$0.50 - $0.99	6,859,995	1.18	0.85	5,529,908	0.85	0.85
$1.00 - $1.49	2,656,666	0.86	1.11	2,573,331	0.85	1.11
$1.50 - $1.99	800,000	0.47	1.56	800,000	0.47	1.56
$2.00 - $2.50	200,000	0.47	2.08	200,000	0.47	2.08
	12,031,671	0.97	$ 0.93	10,618,249	0.77	$ 0.94

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

12. STOCK OPTIONS (continued)

During the year ended December 31, 2011, an amount of $609,705 (2010 – $1,085,784) was charged to operations in recognition of stock-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:

	2011	2010
Assumptions:		
Risk-free interest rate *(%)*	1.12	1.68
Expected life *(years)*	3.00	1.76
Expected volatility *(%)*	57.95	58.48
Expected dividend	Nil	Nil
Results:		
Weighted average fair value of options granted *(per option)*	$ 0.32	$ 0.29

13. NON-CONTROLLING INTERESTS

As consideration for acquiring a mining license from the Government of Lesotho ("GOL"), the Company granted the GOL 25% ownership in Mothae. One half of the interest held by the GOL is a free-carried interest and the other 12.5% will ultimately be paid for by the GOL through its share of future dividends paid by Mothae, if any.

The GOL's equity interest is fixed and cannot be diluted by further equity issuances. As such, the 12.5% free-carried interest portion of the Company's capital contributions into Mothae is accounted for as an equity transaction between shareholders.

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

14. EXPLORATION EXPENDITURES

December 31, 2011	Mothae Diamond	Karowe Mine	Other	Total
Test mining	$ 10,445,720	$ -	$ -	$ 10,445,720
Depreciation	2,227,902	354,445	-	2,582,347
Geology	745,336	-	-	745,336
Office and other	602,717	-	11,864	614,581
Resource development	327,296	-	-	327,296
Environmental impact assessment	232,003	-	-	232,003
Tailings and concentrates	-	-	-	-
Feasibility study	-	(393,402)	-	(393,402)
Diamonds recovered	(7,935,648)	-	-	(7,935,648)
	$ 6,645,326	$ (38,957)	$ 11,864	$ 6,618,233

December 31, 2010	Mothae Diamond	Karowe Mine	Other	Total
Test mining	$ 7,319,740	$ -	$ -	$ 7,319,740
Depreciation	1,357,136	-	-	1,357,136
Geology	414,803	-	-	414,803
Office and other	447,014	476,238	24,825	948,077
Resource development	-	-	-	-
Environmental impact assessment	-	-	-	-
Tailings and concentrates	-	514,494	-	514,494
Feasibility study	-	2,669,553	-	2,669,553
Diamonds recovered	(1,645,085)	-	-	(1,645,085)
	$ 7,893,608	$ 3,660,285	$ 24,825	$ 11,578,718

15. ADMINISTRATION

	2011	2010
Salaries and benefits	$ 2,006,047	$ 1,226,943
Professional fees	1,762,571	492,675
Stock exchange, transfer agent, shareholder communication	1,729,076	241,498
Travel	703,773	667,214
Stock based compensation	609,705	1,085,784
Donations	562,505	267,400
Management fees	505,850	349,416
Office and general	243,999	117,739
Depreciation	59,096	7,028
	$ 8,182,622	$ 4,455,697

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

16. GAIN ON SALE OF DIAMONDS

During the year ended December 31, 2011, Mothae Diamonds held two diamond sales and received gross proceeds of $14.6 million. The sale included the rough diamond inventory that was held at December 31, 2010, which was valued using the Company's best estimate of the lower of cost and net realizable value. The Company has recorded a gain on the sale of this inventory in the amount of $2,339,282. The remaining proceeds from the sale have been netted against exploration expenditures (Note 14).

17. INCOME TAXES

The provision for income taxes differs from the amount computed by applying statutory rates to net loss before income taxes. Reasons for these differences and the related tax effects are as follows:

	2011	2010
Basic statutory tax rate	26.5%	28.5%
Net loss before taxes	18,673,892	15,631,232
Computed income tax recovery	4,948,581	4,454,901
Differences between Canadian and foreign tax rates	(115,852)	(390,760)
Non-deductible expenses	(161,572)	(309,448)
Change in tax rates	(134,730)	(95,634)
Deferred benefits not recognized	(4,259,366)	(5,236,447)
Exchange rate differences	(601,338)	356,452
Other	324,277	1,220,936
	$ -	$ -

The Company did not recognize its deferred tax assets as it is not considered probable that they will be utilized and has no deferred tax liabilities. The movement in deferred tax assets during the year, without taking into consideration the offsetting balances within the same tax jurisdiction, is as follows:

Deferred income tax assets not recognized	2011	2010
Non-capital loss carry forward	$ 13,286,539	$ 7,297,905
Resource pools	95,963	50,237
Share issue, finance costs and other	1,827,666	3,861,757
	$ 15,210,168	$ 11,209,899

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

17. INCOME TAXES (continued)

As at December 31, 2011, the Company has non-capital losses for income tax purposes in Canada, available to offset future taxable income of approximately CAD$25,473,000 (2010 – CAD$11,041,000). These losses, if not utilized, will expire through to 2030. Future tax benefits which may arise as a result of these non-capital losses have not been recognized in these financial statements and have been offset by a valuation allowance.

18. LOSS PER COMMON SHARE

a) *Basic*

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

	2011	2010
Loss for the year – attributable to Shareholders of the Company	$ 18,126,567	$ 13,309,889
Weighted average number of common shares outstanding	360,019,710	223,734,936
	$ 0.05	$ 0.06

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 period), 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.

	2011	2010
Loss for the year – attributable to Shareholders of the Company	$ 18,126,567	$ 13,309,889
Weighted average number of common shares outstanding	360,019,710	223,734,936
Adjustment for stock options	-	-
Weighted average number of common shares for diluted earnings per share	360,019,710	223,734,936
	$ 0.05	$ 0.06

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

19. RELATED PARTY TRANSACTIONS

a) *Related party expenses*

The Company incurred the following expenses with Namdo Management Services Limited ("Namdo") and Lundin Foundation ("LF"), companies related by way of directors in common. In the prior year, the Company incurred air chartered services from Mile High Holdings Ltd. ("Mile High"), a company associated with the Chairman of the Company. The Company also incurred professional geological services and laboratory related expenditures from the Mineral Services Group ("MS Group"), a company that is associated with a director of Company.

Description of services	Related party	2011	2010
Management fees	Namdo	$ 505,850	$ 349,416
Donations	LF	607,020	-
Exploration related expenditures	MS Group	125,598	639,472
Aircraft charter	Mile High	-	41,064
		$ 1,238,468	$ 1,029,952

b) *Related party liabilities*

The liabilities of the Company include the following amounts due to related parties:

	2011	2010
Namdo	$ -	$ 15,962
MS Group	-	151,185
	$ -	$ 167,147

c) *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 executive officers, vice-presidents and members of its Board of Directors.

The remuneration of key management personnel were as follows:

	2011	2010
Salaries and wages	$ 1,253,718	$ 1,033,383
Short term benefits	50,679	43,332
Stock based compensation	439,100	916,915
	$ 1,743,497	$ 1,993,630

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

20. SEGMENT INFORMATION

The Company's primary business activity is the exploration and development of diamond properties in Africa so there is only one reportable operating segment.

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

	Plant and equipment		Mineral properties		Other	
	2011	2010	2011	2010	2011	2010
Canada	$ 259,925	$ -	$ -	$ -	$ 7,766	$ -
Lesotho	4,751,648	5,573,411	21,540,400	24,544,483	141,747	171,879
Botswana	89,489,672	11,918,628	68,502,277	64,610,259	-	34,426
	$ 94,501,245	$ 17,492,039	$ 90,042,677	$ 89,154,742	$ 149,513	$ 206,305

Note 14 contains the geographic distribution of exploration expenditures.

21. 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 and, for items measured at fair value, whether changes in fair value are recognized in the consolidated statements of operations or consolidated statements of comprehensive loss. Those categories are: fair value through profit or loss; loans and receivables; available for sale assets; and, for liabilities, amortized cost.

The fair value of the Company's available for sale financial instruments is derived from quoted prices in active markets for identical assets. The fair value of the Company's long-term debt approximates their carrying amounts due to the fact that there have been no significant changes in the Company's own credit risk. The fair value of all other financial instruments of the Company approximates their carrying values because of the demand nature or short-term maturity of these instruments.

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

21. FINANCIAL INSTRUMENTS (continued)

The Company's financial assets and liabilities are categorized as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
ASSETS			
Loans and receivables			
Cash	$ 22,750,599	$ 8,848,905	$ 6,229,926
Cash equivalents	25,838,810	24,036,000	42,894,000
	48,589,409	32,884,905	49,123,926
Loans receivable	-	-	2,000,000
Other receivables	149,497	56,040	-
	$ 48,738,906	$ 32,940,945	$ 51,123,926
Available for sale			
Investments	109,020	287,308	306,199
	$ 109,020	$ 287,308	$ 306,199
LIABILITIES			
Amortized cost			
Trade payables	$ 11,483,887	$ 3,358,191	$ 1,170,409
Accrued liabilities	5,151,945	3,926,738	-
	16,635,832	7,284,929	1,170,409
Due to related parties	-	167,147	9,976,593
Long-term debt	41,814,658	-	-
	$ 58,450,490	$ 7,452,076	$ 11,147,002

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, 2011	December 31, 2010	January 1, 2010
Level 1			
Investments	$ 109,020	$ 287,308	$ 306,199

Level 2 and Level 3 – N/A

21. FINANCIAL INSTRUMENTS (continued)

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. The operating results and financial position of the Company are reported in U.S. dollars. The fluctuation of the Canadian dollar, Lesotho Maloti, Botswana Pula and South African Rand in relation to the U.S. dollar will consequently have an impact on the financial results of the Company and will also affect the Company's assets, liabilities and equity. The Company has not hedged its exposure to currency fluctuations.

At December 31, 2011, the Company is exposed to currency risk relating to funds held in Canadian dollars of $27.0 million, South African Rand of 127.3 million and Botswana Pula of 8.7 million. Based on this exposure, a 10% change in the Canadian/U.S. dollar, South African Rand/U.S. dollar and Botswana Pula/U.S. dollar exchange rates would give rise to an increase/decrease of approximately $3.1 million in Other Comprehensive Loss. There is no impact on the Statement of Operations resulting from movements in exchange rates.

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 is held through a large Canadian financial institution with a high investment grade rating.

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 head office which monitors rolling forecasts of the Company's liquidity requirements to ensure it has sufficient cash to meet operational needs at all times. Such forecasting takes into consideration the Company's debt financing plans.

The Company's estimated minimum contractual undiscounted cash flow requirements for financial liabilities were:

December 31, 2011	Less than 3 months	3 months to 1 year	2-5 years	Over 5 years
Trade payables and accrued liabilities	$ 16,635,832	$ -	$ -	$ -
Due to related parties	-	-	-	-
Long-term debt	-	16,666,666	33,333,334	-

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

21. FINANCIAL INSTRUMENTS (continued)

December 31, 2010	Less than 3 months	3 months to 1 year	2-5 years	Over 5 years
Trade payables and accrued liabilities	$ 7,284,929	$ -	$ -	$ -
Due to related parties	167,147	-	-	-
Long-term debt	-	-	-	-

Interest rate risk

The Company's exposure to interest rate risk results from the effects that changes in interest rates may have on the reported value of cash and cash equivalents. There is minimal risk that the Company would recognize any loss as a result of a decrease in the fair value of any short-term investments included in cash and cash equivalents due to their short-term nature. Based on the balance of cash and cash equivalents at December 31, 2011, and assuming that all other variables remain constant, a 0.25% change in the U.S. prime rate would result in an increase/decrease of $121,474 in the interest accrued by the Company per annum.

Equity market risk

The Company is exposed to equity price risk arising from its marketable securities, which are classified as available-for-sale.

22. 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 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 that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

The Company's existing current capital resources will not be sufficient to finance the remaining expenditures for the full development and construction of the Karowe Mine, test mining program on the Mothae Project and general corporate expenses over the next twelve months. The timing and completion of these activities are conditional on additional funds being raised either through equity or debt.

23. COMMITMENTS

In conjunction with the development of the Karowe Mine, the Company has committed to approximately $11.5 million in additional capital expenditures.

24. CONTINGENCIES

In April 2010, legal proceedings were initiated against African Diamonds (Plc) (“AFD”), a subsidiary acquired by the Company in 2010, by two former directors of AFD, alleging entitlement to a 3% royalty on production from the Karowe Mine. The claim was heard in the Botswana High Court in early June 2011. The High Court delivered its ruling in August 2011 dismissing the claims against AFD, with costs awarded against the plaintiffs.

In September, the Company was notified that the plaintiffs, in the legal proceedings initiated against AFD, had filed an appeal of the decision of the High Court of Botswana dismissing the plaintiff’s claims with costs awarded in favor of AFD. At this stage the Company does not have any further details as to the timing of when the Appeal will be heard.

25. SUBSEQUENT EVENTS

In February 2012, the Company received a commitment letter from the Bank of Nova Scotia for a $25 million revolving term credit facility. The facility will contain financial and non-financial covenants customary for a facility of this size and nature. The applicable interest rate of any loan under the facility will be determined by the Company’s leverage ratio at any given time. The availability of the facility is subject to the completion of final documentation and customary conditions precedent. The two year facility will be secured by the assets of the Company. Up to $15 million may be advanced prior to the delivery of security over the Company’s Karowe assets.