

# LUCARA

## DIAMOND

Management's Discussion and Analysis  
and  
Consolidated Financial Statements  
Year Ended December 31, 2020

**LUCARA DIAMOND CORP.**  
**ANNUAL MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**December 31, 2020**

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, 2020, which are prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). All amounts are expressed in U.S. dollars unless otherwise indicated.

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

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

The effective date of this MD&A is February 22, 2021.

## **ABOUT LUCARA**

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

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

## **2020 HIGHLIGHTS**

- Mining and processing operations continued without interruption at the Karowe Mine, where more than 98% of the workforce are Botswana Nationals.
- In response to the uncertainty presented by the pandemic, certain operational changes were implemented resulting in significant cost savings without impacting current or future ore mining or carat recoveries.
- Received approval from the Government of the Republic of Botswana ("GRB") to temporarily move quarterly tender sales to Antwerp, Belgium from Gaborone, Botswana.
- A record setting year for the recovery of Specials (single diamonds in excess of 10.8 carats):
  - a 549 carat top-white gem diamond "Sethunya" (February 2020)
  - a 998 carat, high white clivage diamond (November 2020)
  - throughout the year, a total of 34 stones in excess of 100 carats, of which 10 stones exceeded 200 carats

- Two unique collaboration agreements entered into with Louis Vuitton and HB Antwerp to create a high jewellery collection from the historic 1,758 carat “Sewelô”, the largest diamond ever mined in Botswana, and the 549 carat “Sethunya”.
  - An innovative supply agreement with HB Antwerp for the highest value part of Karowe’s production, leading to regular cash flows and the opportunity to participate in additional revenue generated from the sale of polished diamonds.
  - Clara’s customer base increased from 25 to 75 customers (+178% in 2020), with a waiting list of new clients now being maintained.
  - Regular, bi-weekly sales on Clara throughout 2020 provided regular cash flow and visibility into price trends.
  - Work on the Karowe underground expansion project continued with an investment of \$18.7 million under a re-scoped budget focused on de-risking the project schedule (procurement of long lead equipment, detailed design and engineering).
  - The GRB granted a 25 year extension of the mining license at Karowe to 2046, sufficient to cover the remaining open-pit life (to 2026) and the expected life of the proposed underground expansion, currently planned to 2040.
  - Operational highlights from the Karowe Mine included:
    - Continuous operations with implementation of new health and safety protocols to protect the health and well-being of employees, contractors and local communities.
    - Ore and waste mined of 3.0 million tonnes and 2.7 million tonnes, respectively.
    - 2.7 million tonnes of ore processed resulting in 381,706 carats recovered, achieving a recovered grade of 14.3 carats per hundred tonnes.
    - Successful completion of planned XRT upgrades, a key component of the diamond recovery circuit.
  - Financial highlights for the year ended December 31, 2020 included:
    - Total revenues of \$125.3 million (2019: \$192.5 million) or \$335 per carat (2019: \$468 per carat). Revenue from the HB Antwerp agreement will continue to be recognised in 2021 as rough diamonds delivered in 2020 are sold as polished, and “top-up” payments are realised. Price improvement was observed in all size categories in sales concluded in December 2020.
    - Operating cash costs of \$27.80 per tonne processed<sup>(1)</sup> (2019: \$31.88 per tonne processed), 13% lower than the prior year.
    - Adjusted EBITDA<sup>(1)</sup> of \$18.4 million as compared to adjusted EBITDA for the same period in 2019 of \$73.1 million, a decrease driven by lower revenues.
    - Net loss for the year of \$26.3 million (\$0.07 loss per share) as compared to net income of \$12.7 million (\$0.03 per share) in 2019.
    - As at December 31, 2020, the Company had cash and cash equivalents of \$4.9 million and \$30.5 million drawn (\$19.5 million available) from a \$50 million working capital facility. No long-term debt.
- <sup>(1)</sup> Operating cash cost per tonne processed and Adjusted EBITDA are non-IFRS measures (see page 10)
- Recent developments:
    - In January 2021, the Company announced the recoveries of two, top white gem quality diamonds (341 carats and 378 carats) from ore sourced from the M/PK(s) unit within the South Lobe. Both stones were recovered unbroken.

## **DIAMOND MARKET**

The diamond industry begins 2021 with a healthier supply-demand balance than it has had at any stage in the past five years. This follows an incredibly challenging year in 2020, characterized by global travel restrictions, low sales volumes, pricing pressure and overall, difficult economic conditions for miners, manufacturers, retailers and consumers.

Since the end of 2020, the rough market has seen healthy price improvements, supported by a strong holiday sales period. Looking ahead, supply curtailments and a pick up in consumer demand are expected to support a continuation of a stable, positive price trend in both the rough and polished markets. Longer-term fundamentals are expected to remain strong, with the lack of new projects in the pipeline and the expected increase in demand from growth markets, particularly in China, due to rising wealth levels and consumerism.

## **SUPPLY AGREEMENT FOR +10.8 CARAT DIAMOND PRODUCTION**

Karowe's large, high value diamonds have historically accounted for approximately 60% to 70% of Lucara's annual revenues. Though the mine remained fully operational following the declaration of COVID-19 as a global pandemic, Lucara made a decision not to tender any of its +10.8 carat production after early March 2020 amidst the uncertainty caused by the global crisis and the significant weakness observed in the rough diamond market. The polished diamond market performed better through this period and subsequently, in July 2020, Lucara announced a ground breaking partnership agreement with HB Antwerp ("HB"), entering into a definitive supply agreement for the remainder of 2020, for all of the diamonds produced in excess of +10.8 carats from our 100% owned Karowe Diamond mine in Botswana.

Under the supply agreement with HB, Lucara's +10.8 carat production is being sold at prices based on the estimated polished outcome of each diamond, determined through state of the art scanning and planning technology, with a true up amount payable to Lucara on actual achieved polished sales in excess of the initial estimated polished price, less a fee and the cost of manufacturing. This unique pricing mechanism has delivered regular cash flow for this important segment of our production profile. The decision to enter into the supply agreement with HB for the remainder of 2020 followed a trial period during Q2 2020 where approximately 3,100 carats of +10.8 carat rough diamonds were placed into manufacturing ("Shipment 1"). Lucara is receiving payment for the polished diamonds from Shipment 1 as those diamonds are sold by HB to end customers, less a fee and the cost of manufacturing.

For the year ended December 31, 2020, the Company recognized revenue totalling \$55.2 million from the two agreements with HB, including an accrual for estimated variable consideration of \$7.2 million related to "top-up" payments arising from polished diamond sales in excess of the initial purchase price paid to Lucara. Revenue from the HB agreement will continue to be recognised in 2021 as polished diamonds are sold, and "top-up" payments are realised.

## **UPDATE ON COVID-19 RESPONSE**

During 2020, the Karowe Mine remained fully operational under new measures and guidelines implemented by the GRB in late March 2020. These measures designated mining as an essential service in Botswana and included increased travel restrictions, reduced overall staffing levels and appropriate social distancing. The GRB has subsequently extended the state of emergency to March 31, 2021. With increasing cases in Botswana and surrounding countries, restrictions on the movement of people within zones in Botswana and curfews have been implemented and are subject to change with limited notice. The Company was able to continue mining and processing activities during 2020 as most of the workforce (+98%) are Botswana Nationals.

The Company continues to operate under its crisis management strategy, designed to protect the health and well-being of our employees in Botswana and Canada as well as the financial well-being of the business. The Company was recently granted permission to conduct COVID-19 testing at our operations in Botswana and active testing of the workforce began in January 2021. Regular health screening, temperature checks and the use of infrared measurements are a routine part of the operations. The

Company has also constructed several isolation pods for use by the community as a government-sponsored isolation facility has not yet been constructed in the Letlhakane area.

## **KAROWE UNDERGROUND UPDATE**

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

In November 2019, Lucara's Board of Directors approved a \$53 million capital program for the Karowe underground expansion project, with most of the budget scheduled to be spent in the latter part of 2020 and funded through the cash flow from current operations. Given the uncertainty in global markets resulting from COVID-19, the originally planned capital budget was reduced to \$22 million for 2020.

During the year ended December 31, 2020, \$18.7 million was spent on project execution activities including the following: site earthworks (consisting of laydown preparation and clearing of shaft and surface infrastructure locations), geotechnical test pitting and drilling, and completion of two pilot holes at the shaft locations, a 746 metre hole for the ventilation shaft and a 768 metre hold for the production shaft. The Company was able to complete on-site earth works and geotechnical studies by using local contractors while a State of Emergency remained in effect in Botswana. Long lead time item orders were also placed for shaft muckers, and hoist and winder refurbishment was initiated. In addition, power line engineering and detailed shaft design and engineering (consistent with original targets for 2020) progressed. In Q4 2020, the Government of Botswana approved the proposed powerline route and granted a 25-year extension to the Karowe Mine License to 2046, sufficient to cover the remaining open-pit life (to 2026) and the expected life of the proposed underground expansion, currently planned to 2040.

The Company is actively exploring opportunities to arrange debt financing for the underground expansion for those amounts which are expected to exceed the Company's cash flow from operations during the construction period. The underground expansion program has an estimated capital cost of \$514 million and a five year period of development.

## **CLARA**

With global restrictions impeding travel for many diamantaires, interest in Clara, Lucara's digital sales platform, grew significantly in 2020 with the number of buyers on the platform increasing from 27 to 75. During 2020, Clara began selling stones on behalf of third party sellers, which was a significant objective for the year.

Five sales were completed during the fourth quarter of 2020, with total transaction volumes of \$4.6 million increasing the total number of sales in 2020 to twenty-three and total transaction volumes, including third-party transaction volumes, to \$11.6 million. Clara sells rough diamonds, on a stone by stone basis, between 1 and 15 carats and of better qualities. A more frequent sales schedule during 2020 provided current pricing information during a period of significant uncertainty and limited sales. Offered prices and volumes transacted dropped sharply between March and June 2020 but rebounded in the second half of the year. As Clara becomes the online marketplace of choice for rough buyers, discussions are underway with several producers to begin trials for the sale of their diamonds on Clara.

## FINANCIAL HIGHLIGHTS

Table 1

<i>In millions of U.S. dollars, except carats or otherwise noted</i>	Three months ended December 31		Year ended December 31	
	2020	2019	2020	2019
Revenues	\$ 42.4	\$ 56.0	\$ 125.3	\$ 192.5
Net income (loss) for the period	(3.9)	8.7	(26.3)	12.7
Earnings (loss) per share (basic and diluted)	(0.01)	0.02	(0.07)	0.03
Operating cash flow per share*	0.02	0.05	0.04	0.15
Cash on hand	4.9	11.2	4.9	11.2
Amounts drawn on working capital facility	30.5	-	30.5	-
Average price per carat sold (\$/carat)*	402	568	335	468
Operating expenses per carat sold (\$/carat)*	205	209	194	189
Operating margin per carat sold (\$/carat)*	196	359	141	279
Carats sold	105,648	98,547	373,748	411,732

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

The Company recognized revenue of \$42.4 million or \$402 per carat from the sale of 105,648 carats in the fourth quarter of 2020 resulting in a margin of 49%. In comparison, the Company achieved revenues of \$56.0 million or \$568 per carat for its sales in the fourth quarter of 2019. That tender was the strongest tender of 2019 due to a stabilization of rough pricing in all size classes.

Fourth quarter revenue included 89,772 carats sold through tender in December 2020 and the remainder sold through a combination of Clara and HB under the supply agreement announced in July 2020. Under the HB supply agreement, Lucara's +10.8 carat production is being sold at prices based on the estimated polished outcome, with a true up amount paid on the actual achieved polished sales thereafter, less a fee and the cost of manufacturing. The +10.8ct diamonds of poorer quality (clivage low, rejection goods) are sold as rough parcels and do not enter the polishing pipeline at HB. The unique pricing mechanism from the HB sales agreements has delivered regular cash flow for this important segment of our production profile, which represents about 60-70% of Lucara's revenue annually. Regular shipments of +10.8 carat stones commenced in the third quarter of 2020 with payments for the initial value of these shipments received 60 days after delivery to HB. A slower than expected ramp-up in both manufacturing and polished sales resulted in certain amounts, that would otherwise have been recorded as revenue in 2020, now expected to be realized in 2021.

Price recovery was observed in many size classes in the fourth quarter of 2020 and prices achieved for goods sold on Clara (under 10.8 carats in size) in January 2021 have now recovered to the level of pricing achieved early in 2020.

### Q4 2020 Sales Results:

Sales Channel	Rough Carats Sold	Revenue Recognized	Average Price/Carat
HB Agreements <sup>1</sup>	13,045	\$ 28.2 million	\$ 2,160
Clara <sup>2</sup>	2,831	\$ 4.0 million	\$ 1,425
Tender <sup>3</sup>	89,772	\$ 10.2 million	\$ 113
<b>Total</b>	<b>105,648</b>	<b>\$ 42.4 million</b>	<b>\$ 402</b>

- (1) Includes the sale of 2,512 rough carats from Shipment 1.
- (2) Five sales were completed on Clara in Q4 2020, with the sale of third-party goods increasing the total volume transacted to \$4.6 million, a 45% increase in volume compared to Q3 2020. Clara's customer base grew 5% from 71 to 75 customers by December 31, 2020.
- (3) The Q4 2020 tender was held in December in Antwerp; diamonds less than 10.8 carats in size which did not meet quality characteristics for extraction for sale on Clara were sold through tender.

Revenue recognized under the new HB supply agreement is inherently more conservative at the time an initial valuation is determined. This is because while Lucara participates in any upside from the sale of polished stones, the structure of the agreement requires HB to assume all downside risk arising from the manufacturing process. Variable consideration, in the form of “top-up” payments owing when the final polished sales price exceeds the initial payment to Lucara, is estimated when determining the transaction price recognized for accounting purposes, updated at each period end. Upon the sale of the final polished diamonds, Lucara recognizes the top-up achieved. As such, in 2020, the timing of revenue recognition was affected by the change in the sales approach for the Company’s +10.8 carat production and variability arising from the quantity and quality of the goods produced in any period. The new arrangement also resulted in delayed cash flows from operations compared to the prior year. The estimate of variable consideration at December 31, 2020 of \$7.2 million was predominantly based on upgrades achieved for stones polished during the period. As additional stones delivered in 2020 are polished and certainty is achieved regarding the manufactured stones, additional variable consideration is expected. Further revenue from stones delivered to HB in 2020, and included above as rough carats sold, is expected to be realized in 2021 under the HB agreement as those rough diamonds are polished and sold. As certain large, high value diamonds take longer to plan and manufacture (Shipment 1) there is an impact to overall average price as smaller, lower total value stones and rejection stones are sold disproportionately earlier in the process.

Operating expenses were comparable between the two periods, however the operating margin decreased from \$359/carat in Q4 2019 to \$196/carat in Q4 2020 from the reduced revenue recognized in Q4 2020 and a 7% decrease in the number of carats sold. Operating margins continue to be strong at 49% (Q4 2019 – 63%).

*Sales Results for the Year Ending December 31, 2020*

<b>Sales Channel</b>	<b>Rough Carats Sold</b>	<b>Revenue Recognized</b>	<b>Average Price/Carat</b>
HB Agreements <sup>1</sup>	19,556	\$55.2 million	\$2,822
Clara	7,384	\$10.7 million	\$1,452
Tender	346,808	\$59.4 million	\$171
<b>Total</b>	<b>373,748</b>	<b>\$125.3 million</b>	<b>\$335</b>

- (1) Includes 12,493 carats of +10.8 carats stones sold as rough at an average price per carat of \$271 and 7,063 carats placed into manufacturing with revenue recognized as of December 31, 2020 of \$7,334 per carat. Several, large, high value rough diamonds from Shipment 1 have yet to be sold and planning is incomplete on several other large diamonds delivered in 2020. The average 2020 price per carat for the HB Agreements is negatively impacted by the fact that these large, higher value stones have not yet been sold.

The change in sales approach for the +10.8 carat production had the most significant impact on results for the year ended December 31, 2020. The change had a similar impact to the results for the year ended December 31, 2020 as described above in the Q4 sales results. This change affected revenue, loss from mining operations, Adjusted Earnings Before Interest, Tax, Depletion and Amortization (“Adjusted EBITDA”, a non-IFRS measure, see page 10 for details), net income (loss) and earnings (loss) per share when compared to results from the year ended December 31, 2019.

## QUARTERLY RESULTS OF OPERATIONS – KAROWE MINE

Table 2:

	UNIT	Q4-20	Q3-20	Q2-20 <sup>(1)</sup>	Q1-20	Q4-19
<b>Sales</b>						
Revenues generated from the sale of Karowe diamonds in the quarter	US\$M	42.3	41.2	7.3 <sup>(1)</sup>	33.8	56.0
Carats recovered from Karowe sold for revenues recognized during the period	Carats	105,329	112,741	68,861	86,010	98,394
Average price per carat for proceeds received during the period	US\$	401	366	107 <sup>(1)</sup>	393	568
<b>Production</b>						
Tonnes mined (ore)	Tonnes	748,296	678,110	683,282	878,087	694,591
Tonnes mined (waste)	Tonnes	434,082	436,781	591,804	1,199,660	740,593
Tonnes processed	Tonnes	684,768	646,447	705,421	639,430	647,502
Average grade processed	cph <sup>(1)</sup>	14.6	13.8	14.3	14.3	13.3 <sup>(2)</sup>
Carats recovered	Carats	100,059	88,909	101,203	91,536	86,422 <sup>(2)</sup>
<b>Costs</b>						
Operating costs per carats sold (see page 10 Non-IFRS measures)	US\$	205	192	174	201	209
Sustaining capital expenditures	US\$M	4.4	4.7	3.7	2.4	13.0
Underground expansion project	US\$M	8.3	4.8	3.9	1.7	-

(\*) carats per hundred tonnes

- (1) During the three months ended June 30, 2020 the Company made a deliberate decision to withhold from sale all +10.8 carat stones due to market uncertainty arising from the global pandemic. As a result, the quarterly revenue recognized during Q2 2020 and the average price per carat sold are not directly comparable to the other quarterly results presented in the table above.
- (2) Carats recovered during the period included 273 carats recovered from re-processing historic recovery tailings from previous milling and are excluded from the average grade processed.

## FOURTH QUARTER OVERVIEW – OPERATIONS - KAROWE DIAMOND MINE

**Safety:** Karowe had one lost time injury during the three months ended December 31, 2020 resulting in a twelve-month rolling Lost Time Injuries Frequency Rate (“LTIFR”) of 0.43 and an All Injury Frequency Rate of 0.60 (“AIFR”).

**Production:** Ore and waste mined during the fourth quarter of 2020 totaled 0.7 million tonnes and 0.4 million tonnes respectively. Tonnage processed was on target at 0.7 million tonnes, with a total of 100,059 carats recovered. Ore processed was predominantly from the South Lobe. During Q4 2020, a total of 195 Specials (single diamonds larger than 10.8 carats) were recovered including nine diamonds greater than 100 carats in weight. Included in this total were four diamonds greater than 200 carats, including one 998 carat stone.



## SELECT ANNUAL FINANCIAL INFORMATION

<b>Table 4:</b>	<b>Year ended December 31,</b>		
<i>In millions of U.S. dollars unless otherwise noted</i>	<b>2020</b>	2019	2018
Revenues	\$ 125.3	\$ 192.5	\$ 176.2
Operating expenses	(72.6)	(77.7)	(75.7)
<b>Operating earnings <sup>(1)</sup></b>	<b>52.7</b>	<b>114.8</b>	<b>100.5</b>
Royalty expenses	(13.5)	(19.2)	(17.6)
Exploration expenditures	(2.0)	(4.6)	(3.4)
Administration	(16.3)	(15.7)	(16.4)
Sales and marketing	(2.5)	(2.2)	(2.6)
<b>Adjusted EBITDA <sup>(2)</sup></b>	<b>18.4</b>	<b>73.1</b>	<b>60.5</b>
Depletion and amortization	(46.8)	(51.3)	(31.4)
Finance expenses	(2.5)	(3.1)	(2.6)
Foreign exchange gain (loss)	2.2	(2.6)	(2.3)
Loss on disposal of assets	(2.6)	-	-
Current income tax expense	(0.6)	(14.5)	(5.9)
Deferred income tax expense (recovery)	5.7	11.0	(6.7)
<b>Net income (loss) for the year</b>	<b>(26.3)</b>	<b>12.7</b>	<b>11.6</b>
<b>Earnings (loss) per share (basic)</b>	<b>(0.07)</b>	<b>0.03</b>	<b>0.03</b>
<b>Earnings (loss) per share (diluted)</b>	<b>(0.07)</b>	<b>0.03</b>	<b>0.03</b>
<b>Per carat sold:</b>			
<b>Sales price</b>	<b>\$ 335</b>	<b>\$ 468</b>	<b>\$ 502</b>
<b>Operating expenses</b>	<b>194</b>	<b>189</b>	<b>216</b>
<b>Average grade processed (carats per hundred tonnes) <sup>(3)</sup></b>	<b>14.3</b>	<b>14.4</b>	<b>13.9</b>
<b>Cash on hand</b>	<b>\$ 4.9</b>	<b>\$ 11.2</b>	<b>\$ 24.4</b>
<b>Total assets</b>	<b>333.8</b>	<b>346.0</b>	<b>370.1</b>
<b>Total non-current financial liabilities</b>	<b>78.1</b>	<b>87.5</b>	<b>93.7</b>
<b>Change in cash during the year</b>	<b>(6.3)</b>	<b>(13.2)</b>	<b>(36.7)</b>
<b>Dividends paid during the year</b>	<b>-</b>	<b>(22.4)</b>	<b>(30.3)</b>

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

### Revenues

While total revenue increased 9.3% from 2018 to 2019, total revenue decreased 35% to \$125.3 million in 2020 due to a combination of challenging market conditions, and a longer ramp-up for production and polished sales in the latter half of 2020. During the year ended December 31, 2020, Lucara sold 373,748 carats at an average price of \$335 carat (2019: 411,732 carats at an average price of \$468 per carat), a decrease of 9% by volume and 28% by value.

For most of the year ended December 31, 2020, a majority of stones greater than +10.8 carats in size were sold through the supply agreement with HB, with -10.8 carat stones sold through tender and stones in the 1 to 10 carat size classes and better qualities sold through Clara. Stones sold under the terms of the HB sale agreements accounted for approximately 44% of the revenue earned in 2020. Revenue earned under the supply agreement is recognized on a net basis, after deductions for fees and the cost of manufacturing, both payable to HB. Royalties to the Government of Botswana are paid based on the final gross sales price achieved from the sale of all diamonds, rough or polished.

Continued improvements in the process plant including better plant availability, an increasing mine call factor, and stable operations between 2018 and 2020 have led to an increase in the number of diamonds recovered year-over-year. During 2020, Specials recovered equated to 6.7% weight percentage of total

recovered carats, the fourth year to achieve greater than 6% weight percentage of total recovered carats, in line with expectations and a record year by weight for the mine's history (2019 – 6.1%). In 2020, thirty-four stones greater than 100 carats were recovered, of which 10 stones exceeded 200 carats. Of particular note were the recoveries of the top white, 549 carat "Sethunya" in February 2020 and the 998 carat high white clivage stone recovered in November 2020.

Proceeds from two unique collaboration agreements with Louis Vuitton and HB Antwerp, both entered into in 2020, are expected to be realized in 2021. The objective of the collaboration agreements is to create a high jewellery collection from the historic 1,758 carat "Sewelô", the largest diamond ever mined in Botswana, and the 549 carat "Sethunya".

### ***Operating Earnings and Expenses***

Operating earnings for the year ended December 31, 2020 were \$52.7 million (2019: \$114.8 million) after operating expenses of \$72.6 million or \$194 per carat sold (2019: operating expenses of \$77.7 million or \$189 per carat sold), which resulted in an operating margin (before royalties, depletion and amortization) of \$141 per carat or 42% (2019: operating margin of \$279 per carat or 60%). The 7% decrease in operating expenses is from consistent continued operations in 2020, including the decision to defer approximately 2 million tonnes of waste mining to 2022/2023 as a cost savings measure in response to the uncertainty arising from the pandemic. This change, combined with a favourable exchange rate from a weakening of the Botswana Pula compared to the US dollar and insourcing of the process plant contract completed mid-year all contributed to a decrease in operating expenses for the year ended December 31, 2020.

During 2020, Lucara achieved an average grade of 14.3 carats per hundred tonnes ("cpht") during the year compared to an average grade of 14.4 cpht in the prior year. Carat recoveries of 381,706 carats (2019: 403,070 carats recovered, excluding 29,990 carats recovered from re-processing of historic tailings) decreased by 5% as compared to 2019 consistent with the 5% decrease in tonnes processed due to additional planned downtime for the upgrade of XRT technology, a key component of the recovery circuit at the Karowe Mine. In an uncertain year with additional safety measures in place to curb the spread of COVID-19, the operations performed consistently and according to plan throughout 2020.

### ***Depletion and amortization***

In 2020, the Company recorded depletion and amortization expense of \$46.8 million (2019: \$51.3 million). The decrease in this non-cash expense year over year is a direct result of the 5% decrease in carats recovered. Depletion expense on assets that are amortized on a unit of production basis, including deferred stripping costs, is affected by the volume of carats recovered in any given year.

### ***Net income***

Net loss for the year ended December 31, 2020 was \$26.3 million (2019: \$12.7 million net income). Net loss for the year ended December 31, 2020 was materially impacted by decreased revenue due to the change in timing of revenue recognition and the pricing achieved in 2020.

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

Adjusted EBITDA for the year ended December 31, 2020 was \$18.4 million compared to \$73.1 million in 2019. The change year to year is directly attributable to reduced revenue in 2020, offset by a reduction in operating expense of 7%.

Adjusted EBITDA is a non-IFRS measure and is reconciled in Table 4 above.

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

For the year ended December 31, 2020, operating cost per tonne processed was \$27.80 (2019: \$31.88), 13% lower than the prior year. Positive impacts were felt from a 6% depreciation of the Botswana Pula against the U.S. dollar and cost management in a year of uncertainty. Completion of the process plant

contract insourcing contributed to the lower cost, partially offset by a 4% decrease in tonnes processed due to planned XRT upgrades completed in the second and third quarters of 2020.

Operating cost per tonne processed is a non-IFRS measure and is reconciled in Table 6 below to the most directly comparable measure calculated in accordance with IFRS, which is operating expenses.

## NON-IFRS FINANCIAL MEASURES

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

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

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

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

**Table 5: Operating cash flow per share reconciliation:**

<i>In millions of U.S. dollars except weighted average common shares outstanding and operating cash flow per share</i>	<b>Three months ended</b>		<b>Twelve months ended</b>	
	<b>December 31</b>		<b>December 31</b>	
	<b>2020</b>	2019	<b>2020</b>	2019
Cash flows from operating activities	\$ (2,635)	\$ 19,103	\$ (1,526)	\$ 50,092
Add: Changes in non-cash working capital	9,969	1,677	18,793	10,670
Total cash flow from operating activities before changes in non-cash working capital	7,334	20,780	17,267	60,762
Weighted average common shares outstanding	396,896,733	396,858,168	396,889,357	396,790,950
<b>Operating cash flow per share<sup>(1)</sup></b>	<b>\$0.02</b>	\$0.05	<b>\$0.04</b>	\$0.15

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

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

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

**Table 6: Operating cost per tonne of ore processed reconciliation:**

<i>In millions of U.S. dollars with the exception of tonnes processed and operating cost per tonne processed</i>	<b>Twelve months ended December 31,</b>	
	<b>2020</b>	<b>2019</b>
Operating expenses	\$ 72.6	\$ 77.7
Net change rough diamond inventory, excluding depletion and amortization <sup>(1)</sup>	0.3	3.8
Net change ore stockpile inventory, excluding depletion and amortization <sup>(2)</sup>	1.5	7.9
Total operating costs for ore processed	74.4	89.4
Tonnes processed	2,676,066	2,804,517
<b>Operating cost per tonne of ore processed<sup>(3)</sup></b>	<b>\$ 27.80</b>	<b>\$ 31.88</b>

<sup>(1)</sup> Net change in rough diamond inventory, excluding depletion and amortization.

<sup>(2)</sup> Net change in ore stockpile inventory, excluding depletion and amortization.

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

## LIQUIDITY AND CAPITAL RESOURCES

As at December 31, 2020, the Company had cash and cash equivalents of \$4.9 million and had drawn \$30.5 million from its \$50 million working capital facility. After adjustments for working capital items, cash flow expended on operations totalled \$1.5 million.

Working capital as at December 31, 2020 was \$46.7 million as compared to \$60.9 million as at December 31, 2019. The 23% decrease in working capital reflects increases in both accounts receivable, mainly from accrued revenue and taxes receivable, and the credit facility balance. The Company utilized the working capital facility more in 2020 due to the change in sales approach for the +10.8 carat stones and the effects of COVID-19 on rough diamond prices, particularly mid-year.

Amounts available to be drawn from the credit facility totalled \$19.5 million as of December 31, 2020 (\$50.0 million as of December 31, 2019). The facility matures on May 5, 2021. The Company is currently looking to extend the facility in conjunction with the underground expansion project. If the Company is not able to extend, amend or replace that facility, it will be required to repay all amounts drawn as at the maturity date.

Capital spending during the year remained focused on the underground expansion project (2020: \$18.7 million; 2019: \$9.2 million) and sustaining capital expenditures of \$15.2 million (2019: \$17.6 million) including improvements to the XRT technology used in the recovery circuit and raising of the slimes dam walls.

The Company is actively exploring opportunities to arrange debt financing for the underground expansion for those amounts which are expected to exceed the Company's cash flow from operations during the construction period.

Long-term liabilities consist of restoration provisions of \$21.2 million (2019: \$23.6 million), deferred income taxes of \$55.9 million (2019: \$63.0 million), and other non-current liabilities of \$1.0 million (2019: \$0.8 million) which consist of leases reclassified under *IFRS 16: Leases* as of January 1, 2020.

Financing activities during 2020 included draw downs from the working capital facility of \$30.5 million (2019: repayment of \$10.0 million) to manage fluctuations in working capital. In addition, during 2019, the Company paid dividends of \$22.4 million for which there is no comparable allocation in 2020. The Company suspended the quarterly dividend payment in November 2019 to allow excess capital to be directed to the underground expansion program.

The working capital facility contains financial and non-financial covenants customary for a facility of this size and nature. In September 2020, this facility was amended to include FirstRand Bank Limited (London Branch), a division of Rand Merchant Bank, alongside The Bank of Nova Scotia. As at December 31, 2020, the Company was in compliance with all financial and non-financial covenants. Outstanding amounts under the facility bear interest at LIBOR or an alternative base rate plus an applicable margin.

Total shareholders' equity decreased from \$236.9 million as at December 31, 2019 to \$208.2 million as at December 31, 2020, mainly due to increases in the deficit and accumulated other comprehensive loss. Other minor changes to share capital and contributed surplus were related to share units vesting and the recording of share-based compensation during the year.

## RELATED PARTY TRANSACTIONS

A description of key management compensation can be found in Note 16 of the audited consolidated financial statements for the year ended December 31, 2020.

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

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

A profit sharing mechanism also exists, whereby a total of 3.45% of the EBITDA generated by the platform has been assigned to Ms. Thomas (Lucara's CEO and a director) and Ms. McLeod-Seltzer (who was appointed to the Lucara Board of Directors following the Clara acquisition) as founders of the platform, with the remaining 3.22% of the EBITDA generated by the platform to be distributed to management, including Dr. Armstrong (Vice-President, Technical Services) and Ms. Boldt (who was appointed as Lucara's CFO & Corporate Secretary after the Clara acquisition) (collectively, "Clara Management"), at the discretion of Lucara's Compensation Committee based on key performance targets. In March 2020, the EBITDA sharing agreement between Clara and Eira Thomas and Clara and the Clara Management was amended. Under the terms of the amendment, each of Eira Thomas and the Clara Management waived their respective rights to the EBITDA payment to the extent that such payment relates to net income earned by Clara on the sale of rough diamonds from Karowe Mine. This waiver was in effect from the date of the share purchase agreement in February 2019 through to December 31, 2020.

## 2021 OUTLOOK

This section of the MD&A provides management's production and cost estimates for 2021. These are "forward-looking statements" and subject to the cautionary note regarding the risks associated with forward-looking statements.

### **Karowe Mine, Botswana**

**Table 7: 2021 Diamond Sales, Production and Outlook**

<b>Karowe Diamond Mine</b>	<b>Full Year – 2021</b>
<i>In millions of U.S. dollars unless otherwise noted</i>	
Diamond revenue (millions)	\$180 to \$210
Diamond sales (thousands of carats)	350 to 390
Diamonds recovered (thousands of carats)	340 to 370
Ore tonnes mined (millions)	2.8 to 3.2
Waste tonnes mined (millions)	2.8 to 3.4
Ore tonnes processed (millions)	2.6 to 2.9
Total operating cash costs <sup>(1)</sup> including waste mined <sup>(2)</sup> (per tonne processed)	\$28.00 to \$32.00
Botswana general & administrative expenses including marketing costs (per tonne processed)	\$3.00 to \$4.00
Tax rate <sup>(3)</sup>	0% or 25%
Average exchange rate – USD/Pula	11.0

(1) Operating cash costs are a non-IFRS measure. See "Non-IFRS Measures" on page 10.

(2) Includes ore and waste mined cash costs of \$5.00 to \$5.50 (per tonne mined) and processing cash costs of \$11.15 to \$12.15 (per tonne processed).

(3) The Company is subject to a variable tax rate in Botswana based on a profit and revenue ratio which increases as profit as a percentage of revenue increases. The lowest variable tax rate is 22% while the highest variable tax rate is 55% (only if taxable income were equal to revenue). Capital expenditures are deductible when incurred. With planned capital expenditures, a tax rate of 0% is forecasted. Should capital expenditures vary from plan, the tax rate will increase from 0% to 25%.

In 2021, the Company's revenue forecast incorporates an increase in the proportion of carats recovered from the higher value M/PK(S) and EM/PK(S) units within the South Lobe in accordance with the mine plan. The assumptions for carats recovered and sold are consistent with achieved performance in recent years. The number of tonnes processed is also consistent with recent achievements, noting that actual tonnes processed in 2020 was lower than 2019 due to several multi-day shut-downs for upgrades within the XRT recovery circuit. Waste tonnes that were deferred in 2020 as a cost saving measure are expected to be caught up in 2022 and 2023. The estimated processing cost per tonne processed is lower than previous years, reflecting a combination of strong operating performance in the plant and insourcing of the process plant contract in 2020.

The proposed underground expansion at the Karowe Mine has an estimated capital cost of \$514 million and a five year development period. An investment decision, subject to receipt of all required authorizations and the arrangement of financing, is expected in H2 2021. The year one capital spend on the expansion program is expected to be \$105 million. Until financing can be arranged and an investment decision is made, a limited amount of funding has been approved for H1 2021, based on the Company's ability to fund the initial capital expenditures from operating cash flow. Similar to the 2020 program, the 2021 program will focus on early works, including detailed engineering and design work, with the objective of mitigating key risks related to the development schedule.

Lucara Botswana's progressive tax rate computation allows for the immediate deduction of operating costs, including capital expenditures, in the year in which they are incurred. Based on 2021 revenue guidance of \$180 million to \$210 million and assuming the underground development expenditures are incurred, the expected tax rate will be 0% for 2021. Changes to the timing and amount of capital expenditures may result in a rate of up to 25% for 2021.

Sustaining capital and project expenditures are expected to be up to \$21.0 million in 2021, including expenditures associated with further upgrades to the XRT recovery circuit to create redundancy in the Large Diamond Recovery circuit and implementation of body scanning technology (to enhance security) which

had originally been planned for 2020 but was delayed whilst regulatory approval was pending (required approvals were received in Q4 2020).

## **FINANCIAL INSTRUMENTS AND CAPITAL MANAGEMENT**

In the normal course of business, the Company is inherently exposed to certain financial risks, including currency, credit, price and liquidity risks. A discussion of these risks and related assumptions can be found below and in Note 18 in the Company's audited consolidated financial statements for the year ending December 31, 2020. Note 18 includes a discussion of the methods used to value financial instruments, as well as any significant assumptions made as part of the valuation.

### *Credit risk*

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

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

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

### *Price risk*

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

### *Liquidity risk*

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

## **OUTSTANDING SHARE DATA**

As at the date of this MD&A, the Company had 396,896,733 common shares outstanding, 2,946,527 share units, 613,547 deferred share units, and 4,423,000 stock options outstanding under its stock-based incentive plans.

## RISKS AND UNCERTAINTIES

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

### COVID-19 Global pandemic risk

On March 11, 2020, the World Health Organization declared the novel coronavirus ("COVID-19") a global pandemic and on April 2, 2020 the Government of Botswana declared an initial state of emergency. Mining was declared an essential service and as a result, the Karowe Mine continued to operate with additional health and safety protocols implemented. Quarterly diamond tenders were held in Antwerp in June, September and December due to varying international travel restrictions. The Government of Botswana has since extended the state of emergency, which is expected to remain in place until March 31, 2021. Concern remains over how governments across the jurisdictions in which Lucara and many of its customers operate will respond to increasing infection numbers and variants of COVID-19, even as mass vaccination campaigns begin in many countries. Due to the ongoing uncertainty resulting from the global pandemic, Lucara's operations could be impacted in a number of ways including, but not limited to: a suspension of operations at the Karowe Mine, disruptions to supply chains, worker absenteeism due to illness, disruption to the progress of the Karowe Mine underground expansion project and an inability to ship or sell rough and/or polished diamonds during this period. These possible impacts could result from government directives, the need to modify work practices to meet appropriate health and safety standards, a lack of demand for rough and/or polished diamonds, a lack of available liquidity to meet ongoing operational expenses and, due to or by other COVID-19 related impacts on the availability of labour or to the supply chain.

COVID-19 negatively impacted both demand and prices for rough and polished diamonds through much of 2020. As an ongoing risk, the duration and full financial effect of the COVID-19 pandemic is unknown at this time, as is the efficacy of government and central bank interventions in the jurisdictions in which Lucara and its clients operate, the Company's business continuity plan and other mitigating measures. While the impact of COVID-19 is expected to be temporary, the current circumstances are dynamic and the impacts of COVID-19 on our business operations, including the duration and impact that it may have on our ability to ship and sell diamonds, on demand for rough and polished diamonds, on our suppliers, on our employees and on global financial markets, cannot be reasonably estimated at this time. Accordingly, estimates of the extent to which the COVID-19 pandemic may materially and adversely affect the Company's operations, financial results and condition in future periods are also subject to significant uncertainty.

In preparing our consolidated financial statements, we make judgments in applying our accounting policies. In addition, we make assumptions about the future in deriving estimates used in preparing our condensed interim consolidated financial statements. As disclosed in Note 3c of the audited, consolidated financial statements for the year ending December 31, 2020, the most significant sources of estimation uncertainty include estimated recoverable reserves and resources, valuation of mineral properties and plant and equipment, estimated variable consideration in determining revenue, the provision for deferred taxes, the valuation of decommissioning and site restoration provisions, and going concern and liquidity.

Management is required to exercise judgment to ensure that disclosures relating to indicators of impairment, liquidity and the Company's ability to continue as a going concern are appropriate. To this end, the Company manages liquidity risk by maintaining an adequate level of cash and cash equivalents to meet its short-term ongoing obligations and reviews its actual expenditures and forecast cash flows on a regular basis. Changes in demand for rough and/or polished diamonds and diamond prices, production levels and related costs, foreign exchange rates and other factors all impact the Company's liquidity position. In addition, the Company's \$50 million working capital facility matures on May 5, 2021. If the Company is not able to extend, amend or replace that facility, it will be required to repay all amounts drawn



as at the maturity date. As of December 31, 2020, the Company had drawn \$30.5 million for working capital.

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

#### **OFF-BALANCE SHEET ARRANGEMENTS**

With the exception of short-term leases with a term of 12 months or less, the Company is not party to any off-balance sheet arrangements.

#### **ANNUAL MEETING INFORMATION**

The Company's annual general meeting of shareholders will be held on May 11, 2021 in Vancouver, Canada.

#### **CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS**

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, 2020 includes a summary of the significant accounting policies adopted by the Company. The following include the use of significant estimates and judgments:

##### ***Estimated Variable Consideration (Revenue)***

Revenues include Management's estimate of variable consideration receivable under the terms of the HB Antwerp supply agreement. Variable consideration is a component of the transaction price and represents an area of significant management judgment and estimation. Under the HB Antwerp supply agreement, rough diamonds are sold to HB Antwerp and the Company receives an initial payment based on an estimated polished outcome price (less a fee and the cost of manufacturing). If the manufactured diamond is sold to an end buyer for a price higher than the initial estimated polished price received by Lucara a true up payment (variable consideration including in the calculation of the transaction price) is payable by HB Antwerp to the Company once the final sales is made.

Variable consideration is estimated using the most likely approach, as Management considers this approach to be more predictive. The transaction price is reassessed each reporting period, including any estimated amount of variable consideration. The revenue recognized as the transaction price, including any variable consideration, is recognized within the constraint of "*highly probable*".

In evaluating the most likely approach, Management takes into consideration market conditions, the current estimated polished value provided by HB Antwerp (on a stone by stone basis) and the probability that the variable consideration would be realized through the manufacturing process. Any changes in the estimated amount of the variable consideration will affect the reported amounts for revenue, net income (loss) and earnings (loss) per share in a given period as well as other, non-IFRS measures (see page 10) such as operating earnings, Adjusted EBITDA, average price per carat sold and margin.

##### ***Estimated Recoverable Reserves and Resources***

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

but will be affected by forecasted diamond prices, commodity prices, inflation rates, exchange rates, capital and production costs and recoveries amongst other factors.

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

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

### ***Valuation of Mineral Properties and Plant and Equipment***

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

The Company assesses at each reporting period whether there is an indication of impairment. Significant judgment is applied in assessing whether indicators of impairment exist that would necessitate impairment testing. Internal and external factors, such as i) a significant decline in the market value of the Company's share price; ii) changes in the quantity of the recoverable resources and reserves; and iii) changes in diamond prices, capital and operating costs and recoveries; and iv) changes in inflation, interest and exchange rates, are evaluated in determining whether there are any indicators of impairment. Estimated quantities of the recoverable resources and reserves are based on information compiled by qualified persons. Following the release of a new Mineral Resource Estimate for Karowe in mid-2019, the remaining life-of-mine reserve base was adjusted, resulting in a higher depletion rate than in previous years. These estimates are subject to various risks and uncertainties, which may ultimately have an effect on the expected recoverability of the carrying values of the mineral properties and related expenditures.

### ***Income Taxes***

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

### ***Decommissioning and Site Restoration***

The Company has obligations for site restoration and decommissioning related to the Karowe Diamond Mine. The future obligations for decommissioning and site restoration activities are estimated by the Company using mine closure plans or other similar studies which outline the requirements that will be carried out to meet the obligations. Because the obligations are dependent on the laws and regulations of Botswana, the requirements could change as a result of amendments in the laws and regulations relating

to environmental protection and other legislation affecting resource companies. As the estimate of obligations is based on future expectations, a number of assumptions and judgments are made by management in the determination of closure provisions. The decommissioning and site restoration provisions are more uncertain the further into the future the mine closure activities are to be carried out.

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

## **CHANGES IN ACCOUNTING POLICIES**

There have been no changes to accounting policies except the additional revenue policy described in Note 3 of the audited consolidated financial statements for the year ended December 31, 2020.

## **MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS**

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

## **INTERNAL FINANCIAL REPORTING AND DISCLOSURE CONTROLS**

### *Disclosure controls and procedures*

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

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. As of December 31, 2020, the Chief Executive Officer and Chief Financial Officer have each concluded that the Company's disclosure controls and procedures, as defined in NI 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to achieve the purpose for which they have been designed.

### *Internal controls over financial reporting*

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS. Management is also responsible for the design of the Company's internal control over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

The Company's internal controls over financial reporting include policies and procedures that: pertain to the maintenance of records that, in reasonable detail accurately and fairly reflect the transactions and disposition of assets; provide reasonable assurance that transactions are recorded as necessary to permit

preparation of the financial statements in accordance with IFRS and that receipts and expenditures are being made only in accordance with authorization of management and directors of the Company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements.

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's internal controls over financial reporting. As of December 31, 2020, the Chief Executive Officer and Chief Financial Officer have each concluded that the Company's internal controls over financial reporting, as defined in NI 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to achieve the purpose for which they have been designed.

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

### **CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS**

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

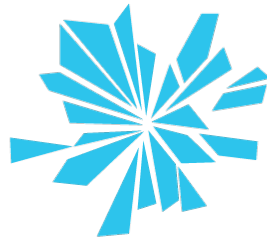
In particular, this MD&A may contain forward looking information pertaining to the following: the impact of COVID-19 pandemic on the Company's operations and cash flows and its plans with respect to the Karowe underground expansion project; the estimates of the Company's mineral reserves and resources;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

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

There can be no assurance that such statements will prove to be accurate, as the Company's results and future events could differ materially from those anticipated in this forward-looking information as a result of those factors discussed in or referred to under the heading "COVID -19 Global Pandemic" in

this MD&A and under the heading “Risks and Uncertainties” in the Company’s AIF, as well as changes in general business and economic conditions, changes in interest and foreign currency rates, the supply and demand for, deliveries of and the level and volatility of prices of rough diamonds, costs and availability of power and diesel, acts of foreign governments and the outcome of legal proceedings, inaccurate geological and recoverability assumptions (including with respect to the size, grade and recoverability of mineral reserves and resources) and unanticipated operational difficulties (including failure of plant, equipment or processes to operate in accordance with specifications or expectations, cost escalations, unavailability of materials and equipment, government action or delays in the receipt of government approvals, industrial disturbances or other job actions, adverse weather conditions, and unanticipated events relating to health safety and environmental matters).

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



**LUCARA**

DIAMOND

Consolidated Financial Statements  
For the year ended December 31, 2020



## Independent auditor's report

To the Shareholders of Lucara Diamond Corp.

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### Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Lucara Diamond Corp. and its subsidiaries (together, the Company) as at December 31, 2020 and 2019, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

#### What we have audited

The Company's consolidated financial statements comprise:

- the consolidated balance sheets as at December 31, 2020 and 2019;
- the consolidated statements of operations for the years then ended;
- the consolidated statements of comprehensive income (loss) for the years then ended;
- the consolidated statements of cash flows for the years then ended;
- the consolidated statements of changes in equity for the years then ended, and
- the notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

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### Basis for opinion

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

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

#### Independence

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

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

"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.



## Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the year ended December 31, 2020. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How our audit addressed the key audit matter
<p><b>Assessment of impairment indicators of plant and equipment and mineral properties</b></p> <p><i>Refer to note 3 – Summary of significant accounting policies, note 7 – Plant and equipment and note 8 – Mineral properties to the consolidated financial statements.</i></p> <p>The Company's total plant and equipment and mineral properties as at December 31, 2020 amounted to \$211 million. Management assesses at each reporting period-end whether there is an indication that an asset or group of assets may be impaired. Management applies significant judgment in assessing whether indicators of impairment exist that would necessitate impairment testing. Internal and external factors, such as (i) a significant decline in the market value of the Company's share price; (ii) changes in quantity of the recoverable resources and reserves; (iii) changes in diamond prices, capital and operating costs and recoveries; and (iv) changes in inflation, interest and exchange rates, are evaluated by management in determining whether there are any indicators of impairment.</p> <p>We considered this a key audit matter due to (i) the significance of the plant and equipment and mineral properties balances and (ii) the significant judgment made by management in assessing whether there are any indicators of impairment, which led to significant audit effort and subjectivity in performing procedures to test management's assessment.</p>	<p>Our approach to addressing the matter included the following procedures, among others:</p> <ul style="list-style-type: none"><li>• Evaluated management's assessment of impairment indicators, which included the following:<ul style="list-style-type: none"><li>– Assessed the completeness of internal or external factors that could be considered as indicators of impairment of the Company's plant and equipment and mineral properties, including consideration of evidence obtained in other areas of the audit.</li><li>– Assessed significant declines in the market value of the Company's share price, which may indicate a decline in value of the Company's plant and equipment and mineral properties.</li><li>– Assessed the changes in diamond prices, the quantity of recoverable resources and reserves, capital and operating costs and recoveries, and inflation, interest and exchange rates by considering external market data, current and past performance of the Company and evidence obtained in other areas of the audit, as applicable.</li></ul></li></ul>





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## **Other information**

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

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

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

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

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

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

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

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

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

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



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

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

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

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

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we



determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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

**/s/ "PricewaterhouseCoopers LLP"**

Chartered Professional Accountants

Vancouver, British Columbia  
February 22, 2021

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

	December 31, 2020	December 31, 2019
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 4,916	\$ 11,197
Receivables and other (Note 5)	20,933	6,248
Inventories (Note 6)	68,374	65,052
	94,223	82,497
Investments	1,651	241
Plant and equipment (Note 7)	107,224	130,108
Mineral properties (Note 8)	104,002	105,243
Intangible assets (Note 9)	21,986	22,774
Other non-current assets	4,763	5,168
<b>TOTAL ASSETS</b>	<b>\$ 333,849</b>	<b>\$ 346,031</b>
<b>LIABILITIES</b>		
Current liabilities		
Trade payables and accrued liabilities	\$ 14,874	\$ 15,880
Credit facility (Note 18)	30,528	-
Tax and royalties payable	1,376	4,397
Lease liabilities	781	1,347
	47,559	21,624
Restoration provisions (Note 10)	21,229	23,629
Deferred income taxes (Note 14)	55,905	63,015
Lease liabilities	963	828
<b>TOTAL LIABILITIES</b>	<b>125,656</b>	<b>109,096</b>
<b>EQUITY</b>		
Share capital (unlimited common shares, no par value)	314,924	314,820
Contributed surplus	8,646	7,679
Deficit	(57,772)	(31,494)
Accumulated other comprehensive loss	(57,605)	(54,070)
<b>TOTAL EQUITY</b>	<b>208,193</b>	<b>236,935</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 333,849</b>	<b>\$ 346,031</b>

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

Commitments – Note 19

Approved on Behalf of the Board of Directors:

“Marie Inkster”  
Director

“Catherine McLeod-Seltzer”  
Director

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

	2020	2019
<b>Revenues</b>	\$ 125,263	\$ 192,541
<b>Cost of goods sold</b>		
Operating expenses	72,643	77,697
Royalty expenses (Note 8)	13,511	19,194
Depletion and amortization	46,841	51,267
	132,995	148,158
<b>Income (loss) from mining operations</b>	(7,732)	44,383
<b>Other expenses</b>		
Administration (Note 13)	16,316	15,651
Exploration	1,964	4,572
Finance expenses	2,487	3,118
Foreign exchange (gain) loss	(2,186)	2,634
Loss on disposal of plant and equipment (Note 7)	2,620	-
Sales and marketing	2,465	2,246
	23,666	28,221
<b>Net income (loss) before tax</b>	(31,398)	16,162
<b>Income tax expense (recovery) (Note 14)</b>		
Current income tax expense	593	14,470
Deferred income tax recovery	(5,713)	(11,022)
	(5,120)	3,448
<b>Net income (loss) for the year</b>	\$ (26,278)	\$ 12,714
<b>Earnings (loss) per common share (Note 15)</b>		
Basic	\$ (0.07)	\$ 0.03
Diluted	\$ (0.07)	\$ 0.03
<b>Weighted average common shares outstanding (Note 15)</b>		
Basic	396,889,357	396,790,950
Diluted	396,889,357	397,912,814

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

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

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	<b>2020</b>	<b>2019</b>
<b>Net income (loss) for the year</b>	\$ (26,278)	\$ 12,714
<b>Other comprehensive income (loss)</b>		
<i>Items that will not be reclassified to net income</i>		
Change in fair value of marketable securities	1,411	(679)
<i>Items that may be subsequently reclassified to net income</i>		
Currency translation adjustment	(4,946)	4,606
	<b>(3,535)</b>	<b>3,927</b>
<b>Comprehensive income (loss) for the year</b>	\$ (29,813)	\$ 16,641

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

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

	2020	2019
<b>Cash flows from (used in):</b>		
<b>Operating activities</b>		
Net income (loss) for the year	\$ (26,278)	\$ 12,714
Items not involving cash and cash equivalents:		
Depletion and amortization	47,879	52,946
Unrealized foreign exchange (gain) loss	(4,136)	2,634
Share-based compensation	1,352	1,186
Deferred income taxes	(5,713)	(11,022)
Loss on disposal of plant and equipment	2,620	-
Finance costs	1,543	2,304
	17,267	60,762
Net changes in working capital items:		
Receivables and other	(12,423)	5,538
Inventories	(973)	(12,523)
Trade payables and other current liabilities	(2,604)	(4,041)
Tax and royalties payable	(2,793)	356
	(1,526)	50,092
<b>Financing activities</b>		
Dividends paid	-	(22,380)
Proceeds (repayments) of credit facility	30,500	(10,000)
Withholding tax for share units vested	(8)	(427)
Interest paid	(110)	(107)
Principal elements of lease payments	(1,011)	(1,421)
	29,371	(34,335)
<b>Investing activities</b>		
Acquisition and disposition of plant and equipment	(15,208)	(17,563)
Mineral property expenditure	(18,661)	(9,178)
Development of intangible assets	(83)	(404)
Acquisition of other assets	-	(1,882)
	(33,952)	(29,027)
<b>Effect of exchange rate change on cash and cash equivalents</b>	(174)	112
<b>Decrease in cash and cash equivalents during the year</b>	(6,281)	(13,158)
<b>Cash and cash equivalents, beginning of year</b>	11,197	24,355
<b>Cash and cash equivalents, end of year<sup>(1)</sup></b>	\$ 4,916	\$ 11,197
<b>Supplemental information</b>		
Taxes paid	(5,115)	(9,751)
Changes in trade payables and accrued liabilities related to plant and equipment	(88)	1,386

<sup>(1)</sup> Cash and cash equivalents are composed of 100% cash deposits held with accredited financial institutions.

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

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

	Number of shares issued and outstanding	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Total
<b>Balance, January 1, 2019</b>	396,509,387	\$ 313,913	\$ 7,766	\$ (21,767)	\$ (57,997)	\$ 241,915
Share-based compensation	-	-	1,186	-	-	1,186
Effect of foreign currency translation	-	-	-	-	4,606	4,606
Change in fair value through other comprehensive income securities	-	-	-	-	(679)	(679)
Shares issued from SUs vested	348,781	907	(907)	-	-	-
Withholding tax for SUs vested	-	-	(427)	-	-	(427)
Dividends paid <sup>(1)</sup>	-	-	61	(22,441)	-	(22,380)
Net income for the year	-	-	-	12,714	-	12,714
<b>Balance, December 31, 2019</b>	396,858,168	\$ 314,820	\$ 7,679	\$ (31,494)	\$ (54,070)	\$ 236,935
<b>Balance, January 1, 2020</b>	396,858,168	\$ 314,820	\$ 7,679	\$ (31,494)	\$ (54,070)	\$ 236,935
Share-based compensation	-	-	1,079	-	-	1,079
Effect of foreign currency translation	-	-	-	-	(4,946)	(4,946)
Change in fair value through other comprehensive income securities	-	-	-	-	1,411	1,411
Shares issued from SUs vested	38,565	104	(104)	-	-	-
Withholding tax for SUs vested	-	-	(8)	-	-	(8)
Net loss for the year	-	-	-	(26,278)	-	(26,278)
<b>Balance, December 31, 2020</b>	396,896,733	\$ 314,924	\$ 8,646	\$ (57,772)	\$ (57,605)	\$ 208,193

<sup>(1)</sup> On April 11, June 20, and September 19, 2019 the Company paid a cash dividend of CA\$0.025 per share.

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



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# LUCARA DIAMOND CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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

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### 1. NATURE OF OPERATIONS AND LIQUIDITY

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

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

#### *COVID-19 Global pandemic*

On March 11, 2020, the World Health Organization declared the novel coronavirus (“COVID-19”) a global pandemic and on April 2, 2020 the Government of Botswana declared an initial state of emergency. Mining was declared an essential service and as a result, the Karowe Mine continued to operate with additional health and safety protocols implemented. Quarterly diamond tenders were held in Antwerp in June, September and December due to varying international travel restrictions. The Government of Botswana has since extended the state of emergency, which is expected to remain in place until March 31, 2021. Concern remains over how governments across the jurisdictions in which Lucara and many of its customers operate will respond to increasing infection numbers and variants of COVID-19, even as mass vaccination campaigns begin in many countries. Due to the ongoing uncertainty resulting from the global pandemic, Lucara’s operations could be impacted in a number of ways including, but not limited to: a suspension of operations at the Karowe Mine, disruptions to supply chains, worker absenteeism due to illness, disruption to the progress of the Karowe Mine underground expansion project and an inability to ship or sell rough and/or polished diamonds during this period. These possible impacts could result from government directives, the need to modify work practices to meet appropriate health and safety standards, a lack of demand for rough and/or polished diamonds, a lack of available liquidity to meet ongoing operational expenses and, due to or by other COVID-19 related impacts on the availability of labour or to the supply chain.

COVID-19 negatively impacted both demand and prices for rough and polished diamonds through much of 2020. As an ongoing risk, the duration and full financial effect of the COVID-19 pandemic is unknown at this time, as is the efficacy of government and central bank interventions in the jurisdictions in which Lucara and its clients operate, the Company’s business continuity plan and other mitigating measures. While the impact of COVID-19 is expected to be temporary, the current circumstances are dynamic and the impacts of COVID-19 on our business operations, including the duration and impact that it may have on our ability to ship and sell diamonds, on demand for rough and polished diamonds, on our suppliers, on our employees and on global financial markets, cannot be reasonably estimated at this time. Accordingly, estimates of the extent to which the COVID-19 pandemic may materially and adversely affect the Company’s operations, financial results and condition in future periods are also subject to significant uncertainty.

As at December 31, 2020, the Company had cash and cash equivalents of \$4.9 million and had drawn \$30.5 million from its \$50 million working capital facility. After adjustments for working capital items, cash flow expended on operations totaled \$1.5 million for the year ended December 31, 2020. Working capital as at December 31, 2020 was \$46.7 million as compared to \$60.9 million as at December 31, 2019. The working capital facility matures on May 5, 2021. The Company is currently in discussions with the lenders with a view to extending the maturity date of the working

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**LUCARA DIAMOND CORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019**

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

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capital facility. If the Company is not able to extend, amend or replace that facility, it will be required to repay all amounts drawn as at the maturity date.

**2. BASIS OF PRESENTATION**

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

These financial statements were approved by the Board of Directors for issue on February 22, 2021.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

*(a) Basis of measurement*

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

*(b) Consolidation*

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

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

*(c) Critical accounting estimates and judgments*

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

*Estimated recoverable reserves and resources* – Mineral reserve and resource estimates are based on various assumptions relating to operating matters. These include production costs, mining and processing recoveries, cut-off grades, long term diamond prices and, in some cases, exchange rates, inflation rates and capital costs. Cost estimates are based on feasibility study estimates or operating history. Estimates are prepared by appropriately qualified persons, but will be affected by forecasted commodity prices, diamond prices, inflation rates, exchange rates, capital and production costs and recoveries amongst other factors. Proven and probable reserves are determined based on a professional evaluation using accepted international standards for the assessment of mineral reserves. The assessment involves geological and geophysical studies and economic data and the reliance on a number of assumptions. The estimates of the reserves may change based on additional knowledge gained subsequent to the initial assessment. This may include additional data available from continuing exploration, results from the reconciliation of actual mining production data against the original reserve estimates, or the impact of economic factors such as changes in the price of commodities or the cost of components of production. Estimated recoverable reserves and resources are used to determine the depletion and amortization of property, plant and equipment at the operating

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# LUCARA DIAMOND CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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

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

mine site, in accounting for deferred stripping costs and mineral properties, determining a deferred tax rate and in performing impairment testing. Therefore, changes in the assumptions used could affect the carrying value of assets, depletion and amortization, changes in the deferred tax rate, and impairment charges recorded in the income statement.

*Valuation of mineral properties and plant and equipment* – The Company carries its mineral properties and plant and equipment at depleted cost less any provision for impairment. The Company assesses at each reporting period whether there is an indication of impairment. Significant judgment is applied in assessing whether indicators of impairment exist that would necessitate impairment testing. Internal and external factors, such as i) a significant decline in the market value of the Company's share price; ii) changes in the quantity of the recoverable resources and reserves; and iii) changes in diamond prices, capital and operating costs and recoveries; and iv) changes in inflation, interest and exchange rates, are evaluated in determining whether there are any indicators of impairment. Estimated quantities of the recoverable resources and reserves are based on information compiled by qualified persons. 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.

*Estimated variable consideration in determining revenue* - Revenues include an estimate of variable consideration receivable under the terms of the Company's sales agreement with HB Antwerp. Variable consideration is a component of the transaction price and represents an area of significant management estimate and judgment. Under the sales agreement, at the time of sale of a rough diamond, the Company receives an initial payment based on an estimated polished outcome price (less a fee and the cost of manufacturing). If the manufactured diamond is sold to an end buyer for a price higher than the initial estimated polished price a true up payment is payable to the Company.

Variable consideration is estimated using the most likely approach, as the Company considers this approach to be more predictive. The transaction price is reassessed each reporting period, including any estimated minimum amount of variable consideration. The revenue recognized as the transaction price, including any variable consideration, is recognized within the constraint of "highly probable". In evaluating the most likely approach, significant judgment includes market conditions, the current estimated polished value provided by HB Antwerp and the probability that the variable consideration would be realized.

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

*Decommissioning and site restoration* – The Company has obligations for site restoration and decommissioning related to the Karowe Diamond Mine. The future obligations for decommissioning and site restoration activities are estimated by the Company using mine closure plans or other similar studies which outline the activities that will be carried out to meet the obligations. Because the obligations are dependent on the laws and regulations of the country in which the mine operates, the requirements could change as a result of amendments in the laws and regulations relating to

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# LUCARA DIAMOND CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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

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

environmental protection and other legislation affecting resource companies. As the estimate of obligations is based on future expectations, a number of assumptions and judgments are made by management in the determination of closure provisions. The decommissioning and site restoration provisions are more uncertain the further into the future the mine closure activities are to be carried out.

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

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

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

#### (d) *Segment reporting*

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

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

#### (e) *Foreign currency translation*

##### *Functional and presentation currency*

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

##### *Transactions and balances*

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

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# LUCARA DIAMOND CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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

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

#### *Group companies*

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

- (i) Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet
- (ii) Income and expenses are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions).
- (iii) All resulting exchange differences are recognized in other comprehensive income as cumulative translation adjustments.

#### *(f) Cash and cash equivalents*

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

#### *(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. All recognized financial assets are measured subsequently at amortized cost or fair value through profit or loss or fair value through other comprehensive income.

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

- (i) *Fair value through profit or loss:* A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges. Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated statement of operations. Gains and losses arising from changes in fair value are presented in the consolidated statement of operations within "other gains and losses" in the period in which they arise.
- (ii) *Fair value through other comprehensive income:* The Company has made an irrevocable election to designate its investments in marketable equity securities as classified at fair value through other comprehensive income. Investment transactions are recognized on the trade date with transaction costs included in the underlying balance. Fair values are determined by reference to quoted market prices at the balance sheet date. When investments in marketable equity securities are disposed of or impaired, the cumulative gains and losses recognized in other comprehensive income are not recycled to profit and loss and remain within equity.
- (iii) *Financial assets and liabilities at amortized cost:* Financial assets and liabilities at amortized cost include cash, trade receivables, credit facility and trade payables and are included in current classification due to their short-term nature. Trade receivables and payables are non-interest bearing if paid when due and are recognized at their face amount, less, when material, a discount, except when fair value is materially different. Amounts drawn on the credit facility are interest-

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# LUCARA DIAMOND CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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

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

bearing and are recorded at fair value upon inception. These are subsequently measured at amortized cost.

#### (h) Inventories

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

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

#### (i) Plant and equipment

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

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

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

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

Residual values and useful lives of assets are reviewed, and adjusted if appropriate, at each balance sheet date.

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

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

#### (j) Exploration and evaluation expenditures

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

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

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

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# LUCARA DIAMOND CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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

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

#### *(k) Mineral properties*

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

#### *(l) Capitalized production stripping costs*

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

#### *(m) Intangible assets*

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

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

#### *(n) Contingent consideration*

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

#### *(o) Impairment of non-financial assets*

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

#### *(p) Provisions*

##### *Asset retirement obligations*

The Company recognizes a liability for an asset retirement obligation on long-lived assets when a present legal or constructive obligation exists, as a result of past events and the amount of the liability

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# LUCARA DIAMOND CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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

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

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

#### *Other provisions*

Provisions are recognized when:

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

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

#### *(q) Income taxes*

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

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

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

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

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

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

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

Uncertain tax positions and interest and penalties related to uncertain tax positions are accounted for under IFRIC 23, Uncertainty over Income Tax Treatments. The Company first determines whether it is more likely than not that a tax position will be sustained upon examination. If a tax position meets the



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# LUCARA DIAMOND CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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

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

more-likely-than-not recognition threshold it is then measured to determine the amount of benefit or liability to recognize in the financial statements. The tax position is measured as the amount of benefit or liability that is likely to be realized upon ultimate settlement. The Company assesses the validity of conclusions regarding uncertain tax positions on a quarterly basis to determine if facts or circumstances have arisen that might cause the Company to change their judgment regarding the likelihood of a tax position.

#### (r) *Share capital*

Common shares are classified as equity.

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

#### (s) *Revenue recognition*

Revenues from diamond sales are recognized when the purchaser obtains control of the diamond. For diamonds sold through tender or Clara, control is achieved when the Company receives payment for the diamonds sold and title is transferred to the purchaser according to contract terms.

In 2020, the Company entered into a new sales agreement to sell its large stone production (diamonds greater than 10.8 carats) to HB Antwerp ("HB"). The purchase price paid for the rough diamonds is based on the initial estimated polished outcome, less a fee and the cost of manufacturing. The Company recognizes net revenue from the sale of rough diamonds when the performance obligations of delivery and analysis of the rough diamond are achieved according to the contract terms. Under the terms of the supply agreement, rough diamonds are sold to HB based on the initial estimated polished outcome price (less a fee and the cost of manufacturing), with a true up paid if the actual achieved polished sales price exceeds the initial price paid. This variable consideration is recognized in determining the transaction price, within the constraint of the likelihood of realization being highly probable, and a final payment is received when the manufactured diamond is sold to an end buyer for a price higher than the initial estimated polished price.

#### (t) *Share-based compensation*

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

Stock options and equity-settled share units granted to employees are measured on the grant date. Stock options granted to non-employees are measured on the date that the goods or services are received. Share units which do not meet the criteria for equity-settlement are recorded as a liability and measured at fair value at each reporting period.

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

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

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# LUCARA DIAMOND CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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

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

#### (u) Earnings (loss) per share

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

#### (v) Leases

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

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

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

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

#### (w) Borrowing costs

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

### 4. ADOPTION OF IFRS PRONOUNCEMENTS

#### IFRS 3 – Business Combinations

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

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

Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16):

These amendments are effective for the Company's annual reporting period beginning January 1, 2022, with early adoption permitted. The amendments prohibit an entity from deducting from the cost of an item of property, plant and equipment and proceeds from selling items produced while bringing that asset to the location and condition necessary for it to be capable of operating in the

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**LUCARA DIAMOND CORP.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019****(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated)**

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manner intended by management. The Company is in the process of assessing the impact of the adoption of this amendment.

None of the remaining standards and amendments to standards and interpretations which have been issued but are not yet effective are expected to have a significant effect on the Company's consolidated financial statements.

**5. RECEIVABLES AND OTHER**

	<b>2020</b>	<b>2019</b>
Trade	\$ 13,396	\$ -
VAT	4,493	3,932
Other	594	208
Prepayments	2,450	2,108
	<b>\$ 20,933</b>	<b>\$ 6,248</b>

Trade receivables at December 31, 2020 were \$13.4 million (2019 – \$nil) due from one customer, HB, under the Company's new sales agreement. The amounts receivable at year-end relate to the timing difference of revenue recognized under the sales agreement and the receipt of payment.

**6. INVENTORIES**

	<b>2020</b>	<b>2019</b>
Rough diamonds	\$ 25,956	\$ 24,536
Ore stockpile	29,572	28,354
Parts and supplies	12,846	12,162
	<b>\$ 68,374</b>	<b>\$ 65,052</b>

Inventory expensed during the year ended December 31, 2020 totaled \$72.6 million (2019 – \$77.7 million). There were no inventory write-downs during the years ended December 31, 2020 and 2019.

# LUCARA DIAMOND CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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

### 7. PLANT AND EQUIPMENT

Cost	Construction in progress	Mine and plant facilities	Vehicles	Furniture and office equipment	Leased assets	Total
<b>Balance, January 1, 2019</b>	\$ 5,661	\$ 206,424	\$ 2,524	\$ 6,729	\$ -	\$ 221,338
IFRS 16 adoption <sup>1</sup>	-	-	-	-	3,691	3,691
Additions	15,936	226	-	17	-	16,179
Reclassification <sup>2</sup>	(10,331)	7,596	104	2,331	-	(300)
Disposals and other	-	-	-	(3)	-	(3)
Translation differences	122	2,152	26	99	32	2,431
<b>Balance, December 31, 2019</b>	\$ 11,388	\$ 216,398	\$ 2,654	\$ 9,173	\$ 3,723	\$ 243,336
Additions	14,655	43	-	138	551	15,387
Reclassification	(15,790)	11,984	360	3,446	-	-
Disposals and other <sup>3</sup>	-	(5,750)	(123)	-	(1,784)	(7,657)
Translation differences	(235)	(2,713)	(24)	82	(128)	(3,018)
<b>Balance, December 31, 2020</b>	\$ 10,018	\$ 219,962	\$ 2,867	\$ 12,839	\$ 2,362	\$ 248,048
<b>Accumulated amortization</b>						
<b>Balance, January 1, 2019</b>	\$ -	\$ 68,511	\$ 1,497	\$ 4,084	\$ -	\$ 74,092
Depletion and amortization	-	34,550	355	1,454	1,565	37,924
Disposals and other	-	-	-	(3)	-	(3)
Translation differences	-	1,112	19	65	19	1,215
<b>Balance, December 31, 2019</b>	\$ -	\$ 104,173	\$ 1,871	\$ 5,600	\$ 1,584	\$ 113,228
Depletion and amortization	-	29,269	343	1,685	987	32,284
Disposals and other <sup>3</sup>	-	(3,116)	(123)	-	(1,460)	(4,699)
Translation differences	-	51	(14)	25	(51)	11
<b>Balance, December 31, 2020</b>	\$ -	\$ 130,377	\$ 2,077	\$ 7,310	\$ 1,060	\$ 140,824
<b>Net book value</b>						
<b>As at December 31, 2019</b>	\$ 11,388	\$ 112,225	\$ 783	\$ 3,573	\$ 2,139	\$ 130,108
<b>As at December 31, 2020</b>	\$ 10,018	\$ 89,585	\$ 790	\$ 5,529	\$ 1,302	\$ 107,224

(1) Additions include \$3,691 recorded to leased assets upon the adoption of IFRS 16, Leases on January 1, 2019.

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

(3) During the year ended December 31, 2020, a loss on disposal of assets of \$2,620 was recorded related to the replacement of several XRT machines.

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FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019****(All amounts expressed in thousands of U.S. Dollars, unless otherwise indicated)**

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**8. MINERAL PROPERTIES**

<b>Cost</b>	<b>Capitalized production stripping asset</b>		<b>Karowe Mine</b>		<b>Total</b>
<b>Balance, January 1, 2019</b>	\$	72,352	\$	73,372	\$ 145,724
Additions		-		10,320	10,320
Reclassification <sup>1</sup>		-		174	174
Translation differences		676		811	1,487
<b>Balance, December 31, 2019</b>	\$	73,028	\$	84,677	\$ 157,705
Additions		-		18,749	18,749
Adjustment to restoration asset		-		(3,199)	(3,199)
Translation differences		(1,083)		(348)	(1,431)
<b>Balance, December 31, 2020</b>	\$	71,945	\$	99,879	\$ 171,824
<b>Accumulated depletion</b>					
<b>Balance, January 1, 2019</b>	\$	11,584	\$	21,031	\$ 32,615
Depletion		12,583		6,727	19,310
Translation differences		258		279	537
<b>Balance, December 31, 2019</b>	\$	24,425	\$	28,037	\$ 52,462
Depletion		10,250		4,998	15,248
Translation differences		236		(124)	112
<b>Balance, December 31, 2020</b>	\$	34,911	\$	32,911	\$ 67,822
<b>Net book value</b>					
<b>As at December 31, 2019</b>	\$	48,603	\$	56,640	\$ 105,243
<b>As at December 31, 2020</b>	\$	37,034	\$	66,968	\$ 104,002

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

**Karowe Mine**

A royalty of 10% of the gross sales value of diamonds produced from Karowe is payable to the government of Botswana, regardless of whether the diamond is sold as rough or polished. During the year, the Company incurred a royalty expense of \$13.5 million (2019: \$19.2 million).

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**LUCARA DIAMOND CORP.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**9. INTANGIBLE ASSETS**

<b>Cost</b>	
<b>Balance, January 1, 2019</b>	\$ 21,798
Development expenditures	404
Translation differences	1,001
<b>Balance, December 31, 2019</b>	\$ 23,203
Development expenditures	83
Translation differences	512
<b>Balance, December 31, 2020</b>	<b>\$ 23,798</b>
<b>Accumulated Depletion</b>	
<b>Balance, January 1, 2019</b>	\$ -
Additions	(429)
<b>Balance, December 31, 2019</b>	\$ (429)
Additions	(1,298)
Translation differences	(85)
<b>Balance, December 31, 2020</b>	<b>\$ (1,812)</b>
<b>Net book value</b>	
<b>As at December 31, 2019</b>	\$ 22,774
<b>As at December 31, 2020</b>	<b>\$ 21,986</b>

In 2018, the Company acquired the Clara platform, a secure, digital sales platform for rough diamonds. The consideration paid was allocated entirely to the intangible assets. As part of the purchase, contingent consideration was agreed to and will be recognized as additional purchase consideration for the intangible asset, if the obliging events occur. The contingent consideration consists of a profit-sharing allocation: cash payments based on 3.45% of the annual EBITDA generated by the sales platform and a pre-existing 13.3% annual EBITDA performance based contingent payments payable to the founders of the technology, to a maximum of \$20.9 million per year for 10 years and additional Lucara share payments to a combined maximum of 13.4 million shares if certain revenue triggers are reached beginning at \$200 million of cumulative revenue to \$1.6 billion of cumulative revenue.

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

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**10. RESTORATION PROVISIONS**

The Company's restoration provisions relate to the rehabilitation of the Karowe Diamond Mine in Botswana. 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 5.9% at December 31, 2020 (2019 – 8.9%) and an inflation rate of 4.0% at December 31, 2020 (2019 – 4.0%). Rehabilitation costs at the Karowe Diamond Mine are expected to commence during 2046 (the end of the current mining license). The estimated liability for reclamation and remediation costs on an undiscounted basis is approximately \$33.7 million (2019 - \$27.1 million).

		<b>2020</b>		<b>2019</b>
<b>Balance, beginning of year</b>	\$	23,629	\$	20,184
Changes in rates and estimates		(3,800)		1,142
Accretion of liability component of obligation		1,863		2,200
Foreign currency translation adjustment		(463)		103
<b>Long-term portion of restoration provisions</b>	<b>\$</b>	<b>21,229</b>	<b>\$</b>	<b>23,629</b>

**11. SHARE BASED COMPENSATION**

## a. Stock options

The Company's stock option plan (the 'Option Plan') was approved by the Company's shareholders initially on May 13, 2015, with amendments approved on May 10, 2019. Under the terms of the Option Plan, a maximum of 20,000,000 shares had been reserved for issuance upon the exercise of stock options. At the 2020 Shareholder meeting, this maximum was subsequently reduced to 10,000,000 shares reserved for issuance upon the exercise of stock options, with the difference allocated for issuance under the Company's share unit plans as described in note 11(b) below. The Option Plan provides the Board of Directors with discretion to determine the vesting period for each stock option grant. Options typically vest in thirds over a three-year period beginning on the first anniversary of the date of grant and expire four years from the date of grant.

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

	<b>Number of shares issuable pursuant to stock options</b>	<b>Weighted average exercise price per share (CA\$)</b>
<b>Balance at January 1, 2019</b>	4,278,336	\$ 2.40
Granted	1,437,000	1.64
Expired	(703,336)	2.13
Forfeited	(490,000)	2.54
<b>Balance at December 31, 2019</b>	4,522,000	2.19
Granted	1,604,000	0.77
Expired	(1,480,000)	2.45
Forfeited	(223,000)	1.52
<b>Balance at December 31, 2020</b>	<b>4,423,000</b>	<b>\$ 1.62</b>

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**11. SHARE BASED COMPENSATION (continued)**

Options to acquire common shares have been granted and which are outstanding at December 31, 2020 are as follows:

Range of exercise prices CA\$	Number of options outstanding	Outstanding Options		Exercisable Options		
		Weighted average remaining contractual life (years)	Weighted average exercise price (CA\$)	Number of options exercisable	Weighted average remaining contractual life (years)	Weighted average exercise price (CA\$)
\$0.50 - \$1.00	1,532,000	3.17	0.77	-	-	-
\$1.50 - \$2.00	1,341,000	2.15	1.64	447,000	2.15	1.64
\$2.01 - \$2.50	1,175,000	1.29	2.33	783,333	1.29	2.33
\$2.51 - \$3.00	375,000	0.25	2.76	375,000	0.25	2.76
	<b>4,423,000</b>	<b>2.11</b>	<b>\$ 1.62</b>	<b>1,605,333</b>	<b>1.29</b>	<b>\$ 2.24</b>

During the year ended December 31, 2020, an amount of \$0.3 million (2019 – \$0.4 million) was charged to operations in recognition of share-based compensation expense, based on the vesting schedule for the options granted.

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

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

**b. Restricted and performance share units**

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

For the year ended December 31, 2020, the Company recognized a share-based payment charge of \$0.7 million (2019: \$0.8 million) for the SUs granted during the year.



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**11. SHARE BASED COMPENSATION (continued)**

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

## c. Deferred share units

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

For the year ended December 31, 2020, the Company recognized a share-based payment charge of \$0.3 million (2019: \$nil) for the DSUs granted during the period.

	Number of share units	Estimated fair value (CA\$)	
February 26, 2020 grant	278,000	\$	0.77
May 7, 2020 vesting	(74,000)		0.51
July 2, 2020 grant	90,923		0.62
September 30, 2020 grant	159,312		0.50
December 31, 2020 grant	159,312		0.50
<b>Balance at December 31, 2020</b>	<b>613,547</b>	<b>\$</b>	<b>0.52</b>

# LUCARA DIAMOND CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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### 12. PRINCIPAL SUBSIDIARIES

The Company had the following subsidiaries at December 31, 2020 and 2019:

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

(1) Intermediate holding company

(2) Incorporated on July 31, 2019.

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

### 13. ADMINISTRATION

	2020	2019
Salaries and benefits	\$ 6,510	\$ 5,943
Professional fees	2,413	2,612
Insurance, office and general <sup>1</sup>	2,540	1,554
Marketing	859	949
Stock exchange, transfer agent, shareholder communication	300	369
Travel	360	822
Share-based compensation (Note 11)	1,352	1,186
Management fees	219	458
Depreciation	1,039	1,679
Sustainability and donations <sup>1</sup>	724	79
	<b>\$ 16,316</b>	<b>\$ 15,651</b>

(1) Included are amounts incurred for the Company's COVID-19 response totalling \$826 for the year ended December 31, 2020, including a \$298 donation to the Government of Botswana's COVID-19 Response Fund.

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**14. INCOME TAXES**

	<b>2020</b>	<b>2019</b>
Current	\$ 593	\$ 14,470
Deferred	(5,713)	(11,022)
<b>Income tax (recovery) expense</b>	<b>\$ (5,120)</b>	<b>\$ 3,448</b>

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

	<b>2020</b>	<b>2019</b>
Statutory tax rate	27.00%	27.00%
Net income before tax	(31,398)	16,162
Computed income tax (recovery) expense	(8,477)	4,364
Differences between Canadian and foreign tax rates	969	(1,257)
Non-deductible expenses and other permanent differences	1,011	1,615
Deferred tax effect of Botswana variable tax rate in excess of Botswana standard tax rate	(2,024)	(3,120)
Change in deferred benefits not recognized	2,837	1,783
Exchange rate differences	(293)	223
Withholding taxes	857	(160)
	<b>\$ (5,120)</b>	<b>\$ 3,448</b>

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

The Company has not recognized deferred tax liabilities in respect of historical unremitted earnings from foreign subsidiaries for which the Company is able to control the timing of the remittance and which are considered by the Company to be reinvested for the foreseeable future. At December 31, 2020, these earnings amount to \$156.9 million (2019: \$157.8 million). All of these earnings would be subject to withholding taxes if they were remitted by the foreign subsidiaries.

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

	<b>2020</b>	<b>2019</b>
<b>Balance, beginning of year</b>	<b>\$ 63,015</b>	<b>\$ 73,482</b>
Deferred income tax recovery	(5,713)	(11,022)
Foreign currency translation adjustment	(1,397)	555
<b>Balance, end of year</b>	<b>\$ 55,905</b>	<b>\$ 63,015</b>

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**LUCARA DIAMOND CORP.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**14. INCOME TAXES (continued)**

<b>Deferred income tax assets and liabilities recognized</b>	<b>2020</b>	<b>2019</b>
<i>Deferred income tax assets</i>		
Non-capital losses	\$ 6,976	\$ 180
Accounts payable and other	1,598	731
Unrealized foreign exchange loss	-	1,003
Restoration provisions	7,131	7,937
Total deferred income tax assets	15,705	9,851
<i>Deferred income tax liabilities</i>		
Mineral properties, plant and equipment	66,856	72,422
Future withholding taxes	625	444
Unrealized foreign exchange gains	1,995	-
Other	2,134	-
Deferred income tax liabilities	71,610	72,866
Deferred income tax liabilities, net	\$ 55,905	\$ 63,015
<b>Deferred income tax assets not recognized</b>		
Tax losses	\$ 26,611	\$ 22,581
Mineral property, plant and equipment	43	110
Other deductible temporary differences	675	273
	\$ 27,329	\$ 22,964

As at December 31, 2020, the Company has non-capital losses for income tax purposes which expire as follows:

	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>Subsequent to 2023</b>	<b>No expiry date</b>	<b>Total</b>
Botswana	\$ -	\$ -	\$ -	\$ -	\$ 15,466	\$ 15,466
Canada	-	-	-	94,317	-	94,317
United Kingdom	-	-	-	-	6,042	6,042
	\$ -	\$ -	\$ -	\$ 94,317	\$ 21,508	\$ 115,825

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

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**15. EARNINGS (LOSS) PER COMMON SHARE***a) Basic*

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

	<b>2020</b>	<b>2019</b>
Income (loss) for the year	\$ (26,278)	\$ 12,714
Weighted average number of common shares outstanding	396,889,357	396,790,950
	<b>\$ (0.07)</b>	<b>\$ 0.03</b>

*b) Diluted*

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

	<b>2020</b>	<b>2019</b>
Income (loss) for the year	\$ (26,278)	\$ 12,714
Weighted average number of common shares outstanding	396,889,357	396,790,950
Adjustment for stock options	-	-
Adjustment for share units	-	1,121,864
Weighted average number of common shares for diluted earnings (loss) per share	396,889,357	397,912,814
	<b>\$ (0.07)</b>	<b>\$ 0.03</b>

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**16. RELATED PARTY TRANSACTIONS***Key management compensation*

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

	<b>2020</b>	<b>2019</b>
Salaries and wages, including directors' fees	\$ 2,290	\$ 2,499
Short term benefits	32	82
Share-based compensation	976	573
	<b>\$ 3,298</b>	<b>\$ 3,155</b>

*a) Clara acquisition*

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

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

*b) Other related parties*

For the year ended December 31, 2020, the Company paid \$nil (2019: \$0.1 million) to a charitable foundation directed by certain of the Company's directors to carry out social programs on behalf of the Company in Botswana. For the year ended December 31, 2020, the Company paid \$0.2 million (2019: \$0.5 million) to a management company directed by certain of the Company's directors for office space and office management services.

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**17. SEGMENT INFORMATION**

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

<b>2020</b>			
	<b>Karowe Mine</b>	<b>Corporate and other</b>	<b>Total</b>
Revenues <sup>(1)</sup>	\$ 124,490	\$ 773	\$ 125,263
Loss from mining operations	(5,648)	(2,084)	(7,732)
Exploration expenditures	(1,964)	-	(1,964)
Finance expenses	(2,073)	(414)	(2,487)
Foreign exchange gain/(loss)	2,298	(112)	2,186
Loss on disposal of assets	(2,620)	-	(2,620)
Other	(8,883)	(9,898)	(18,781)
Taxes	5,120	-	5,120
<b>Net loss for the year</b>	<b>(13,770)</b>	<b>(12,508)</b>	<b>(26,278)</b>
<b>Capital expenditures</b>	<b>(33,869)</b>	<b>(83)</b>	<b>(33,952)</b>
<b>Total assets</b>	<b>307,892</b>	<b>25,957</b>	<b>333,849</b>
<b>2019</b>			
	<b>Karowe Mine</b>	<b>Corporate and other</b>	<b>Total</b>
Revenues <sup>(1)</sup>	\$ 191,937	\$ 604	\$ 192,541
Income (loss) from mining operations	44,620	(237)	44,383
Exploration expenditures	(4,572)	-	(4,572)
Finance expenses	(2,595)	(523)	(3,118)
Foreign exchange loss	(2,290)	(344)	(2,634)
Other	(7,867)	(10,030)	(17,897)
Taxes	(3,448)	-	(3,448)
Net income (loss) for the year	23,848	(11,134)	12,714
Capital expenditures	(26,741)	(404)	(27,145)
Total assets	319,080	26,951	346,031

<sup>(1)</sup> During the year ended December 31, 2020, one customer generated 44% of the Company's 2020 revenue. During the year ended December 31, 2019, one customer generated 12% of the Company's 2019 revenue.

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

	<b>Plant and equipment</b>		<b>Mineral properties</b>		<b>Other</b>	
	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>
Canada	\$ 102	\$ -	\$ -	\$ -	\$ 21,986	\$ 23,015
Belgium	147	-	-	-	-	-
Botswana	106,975	130,108	142,002	105,243	4,764	5,168
	\$ 107,224	\$ 130,108	\$ 142,002	\$ 105,243	\$ 26,750	\$ 28,183

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**17. SEGMENT INFORMATION (continued)**

\$1.3 million of depletion expense in 2020 (2019 - \$0.4 million) relates to intangible assets located in Canada. All remaining depletion and amortization expense relates to the assets at the Karowe Mine located in Botswana.

**18. FINANCIAL INSTRUMENTS****a) Measurement categories and fair values**

As explained in Note 3, financial assets and liabilities have been classified into categories that determine their basis of measurement. Those categories are: fair value through profit and loss; fair value through other comprehensive income and amortized cost.

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

**b) Fair value hierarchy**

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

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

	December 31, 2020	December 31, 2019
Level 1: Fair value through other comprehensive income		
– Investments	\$ 1,651	\$ 241
Level 2: N/A		
Level 3: N/A		

**c) Financial risk management**

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

**Currency risk**

The Company is exposed to the financial risk related to fluctuating foreign exchange rates. All sales revenues are denominated in U.S. dollars, while directly related costs are denominated in Botswana Pula. At December 31, 2020, the Company is exposed to currency risk relating to U.S. dollar cash held within its subsidiaries with Canadian or Pula functional currency. Based on this exposure, a 10% change in the U.S. dollar exchange rate would give rise to an increase/decrease of approximately \$0.4 million in net income for the year.



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# LUCARA DIAMOND CORP.

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### 18. FINANCIAL INSTRUMENTS (continued)

#### *Credit risk*

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

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

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

#### *Price risk*

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

#### *Liquidity risk*

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

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# LUCARA DIAMOND CORP.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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

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### 18. FINANCIAL INSTRUMENTS (continued)

#### *Revolving credit facility*

The Company has a \$50 million revolving term credit facility with a maturity date of May 5, 2021. In September 2020, this facility was amended to include FirstRand Bank Limited (London Branch), a division of Rand Merchant Bank alongside The Bank of Nova Scotia. Funds drawn under the revolving credit facility are due in full at maturity. The facility contains financial and non-financial covenants customary for a facility of this size and nature. As part of the amendment, Lucara agreed to limit capital expenditures related to the underground expansion project to \$22 million during 2020. As at December 31, 2020, the Company was in compliance with all financial and non-financial covenants. Outstanding amounts under the facility bear interest at LIBOR or an alternative base rate plus an applicable margin based on the Company's adjusted leverage ratio.

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

As at December 31, 2020, \$30.5 million was drawn on the facility for working capital purposes (2019 - \$nil). The current interest rate on the amount drawn is LIBOR plus a margin of 3.50%. At December 31, 2020, \$19.5 million was available.

### 19. COMMITMENTS

As at December 31, 2020, \$9.9 million in commitments relates to purchase orders and contracts for services to be provided related to the underground expansion project. Of the \$9.9 million, \$9.8 million relates to expenditures in 2021 and \$0.1 million relates to expenditures in 2022. The total of all commitments can be cancelled at a cost of \$1.1 million as of December 31, 2020.

### 20. CAPITAL MANAGEMENT

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

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

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

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