Lucara Diamond Corp.

ANNUAL REPORT

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LUCARA DIAMOND CORP.
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2010

This management's discussion and analysis of results of operations ("MD&A") describes material factors that have affected the performance of Lucara Diamond Corp. (the "Company" or "Lucara") and its subsidiaries during the year ended December 31, 2010, and factors that may affect its future performance. The following information should be read in conjunction with the audited consolidated annual financial statements for the year ended December 31, 2010, the five months ended December 31, 2009 and the year ended July 31, 2009, together with the notes thereto, prepared by management in accordance with Canadian generally accepted accounting principles. All amounts presented are in US dollars unless otherwise indicated. The effective date of this MD&A is April 18, 2011.

Some of the statements in this MD&A are forward-looking statements that are subject to risk factors set out in the cautionary note contained herein.

Additional information about the Company and its business activities is available on SEDAR at www.sedar.com .

HIGHLIGHTS - OUTSTANDING

AK6 Diamond Project – Botswana

- An agreement was signed with African Diamonds plc to acquire all of the outstanding common shares and share purchase options of African Diamonds plc. The transaction was completed in December 2010 upon which date Lucara indirectly owns 100% of the AK6 Diamond Project.
- The Engineering, Procurement and Construction Management ("EPCM") contract for the construction of a mine and associated facilities was awarded to Dowding Reynard and Associates ("DRA") on July 16, 2010.
- By year end engineering was 40% complete and all major equipment orders had been placed and procurement was 55% complete. As at end first quarter 2011 engineering was 82% complete and the project was overall 40% complete.
- Botswana Power Corporation has awarded the construction contracts for the bulk power line construction which is due to be complete in July.
- The Government of the Republic of Botswana approved an amendment to the mining license to allow the sale of the entire AK6 production of diamonds either through open tender sales or exclusive contract.

Mothae Diamond Project – Lesotho

- Test mining commenced in May 2010 and a total of 138,798 dry tonnes of kimberlite was processed to the end of December 2010. This includes 137,741 dry tonnes of C domain kimberlite, which is the initial focus of the current test mining program, and 1,592 dry tonnes of F domain kimberlite stockpiled during the prior bulk sampling work.
- Plant upgrades and commissioning were completed, design capacity throughput achieved and sustained.

- Additional 3,671 carats ("cts") of diamond recovered in 2010, including 20 stones greater than 5 cts, 8 stones greater than 10 cts and 3 stones greater than 20 cts.
- The three largest stones recovered in 2010 were 53.53 cts, 37.24 cts and 20.26 cts.
- As of March 23, 2011, a total of 175,000 dry tonnes had been processed from the C domain, producing 5,484 cts at an average grade of 3.13 carats per hundred tonnes ("cpht"). Ongoing audit work will confirm the grades and diamond recovery efficiency.
- In March 2011, the first tender of Mothae diamonds was held in Antwerp. A total of 9,381.35cts were sold at an average of $871.70ct for total gross proceeds of $8.18M.
- The three highest per carat value diamonds sold were a 13.87ct stone, which sold for $43,000 per carat, a 24.57ct stone, which sold for $32,351 per carat and a 20.13ct stone, which sold for $27,995 per carat.

INTRODUCTION

Lucara is a diamond development company focused in Africa. The business of Lucara consists of the acquisition, exploration and development of diamond properties. The Company's head office is in Vancouver, BC Canada and its common shares trade on the TSX Venture Exchange under the symbol "LUC".

The principal assets of Lucara and the focus of Lucara's development and exploration activities are its interest in mining, exploration and prospecting diamond licenses in Lesotho, Botswana and Namibia. In addition, Lucara actively seeks development and growth opportunities to bring new projects into its portfolio.

DEVELOPMENT AND EXPLORATION UPDATE

Land status

The following summarizes the Company's current land holdings:

Country	Project Name and Interest Held	Area (km2)
Lesotho	Mothae Diamond Mining Lease (75% interest)	20
Botswana	Boteti AK6 Diamond Mining License (100% interest)	15.3
Namibia	Kavango Prospecting License (10) (100% interest)	8,359

Boteti AK6 Diamond Project, Botswana

In December 2009, the Company, through its indirect wholly-owned subsidiary Boteti Diamond Holdings Inc. ("Boteti Diamond"), acquired an initial 70.268% interest in Boteti Mining (Pty) Limited ("Boteti"). In April 2010, African Diamonds exercised its option to increase its interest in Boteti by a further 10.268% in consideration of a cash payment of $7.3 million to the Company. After the exercise of the option, Boteti was held 60% held by Boteti Diamond and 40% held by African Diamonds.

In December 2010, the Company acquired African Diamonds' non-controlling interest in Boteti for consideration of 80,245,726 common shares of the Company on the basis of 0.80 ("Ratio") of a common share of the Company in exchange for every one common share in the capital of African Diamonds.

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

In June 2010, a definitive feasibility study updating previous work to a confidence level to support project approval was completed. The study detailed a cost effective technical solution with a process plant initially designed at a throughput rate of 2.5 million tonnes per annum ("mtpa") increasing to 4.0 mtpa after 4 years. This phased production approach, combined with contract mining reduces up-front capital required to bring this project on stream.

As part of the feasibility study, a resource update was completed on the project. From an Indicated Resources of 51 million tonnes ("mt") containing 8.2 million carats of diamonds, the mine design delineates a Probable Reserve of 36.2 million tonnes of ore, containing 6.3 million carats of diamonds, using a 1.5mm bottom cut off size, in an open pit to a depth of 324 metres. The reserves will be mined over an estimated 12 year mine life.

A formal decision was made to proceed with the construction of the AK6 diamond mine which is estimated to require a capital investment of approximately US$120-US$130 million (based on ZAR/US$ exchange rate of R7.00 to 7.50), which includes the process plant and all mine site and off-site infrastructure. Operating costs over the life of mine are estimated to average US$17.51 per tonne treated (based on ZAR/US of R7.53).

Project development activities commenced upon completion of the feasibility study with the selection of Dowding Reynard and Associates ("DRA") as the engineering, procurement and construction management contractor. The project development focus areas in 2010 were the critical path activities to ensure that ramp up to full production in the first quarter of 2012 is achieved. By year end engineering was 40% complete and all major equipment orders had been placed and procurement was 55% complete. The earthworks contract for the site civil works and the access road upgrade was awarded and the contractor mobilized to site in September 2010.

During 2010, parties affected by the mine development were relocated in accordance with the Botswana Land Board assessment report as a minimum. Relocation and resettlement claims were finalized to all parties' satisfaction.

Agreements were reached with Botswana Power Corporation for the supply of power to project and Debswana Diamond Company (PTY) Ltd, to use their existing construction camp. The bulk power line contract was put out to tender and the contract was awarded in March 2011, and grid power is anticipated to be available in July 2011 in time for early commissioning tasks.

Amendments to certain provisions of the mining license with the Government of the Republic of the Botswana ("GRB") were concluded. The mining license was amended to allow the sale of the entire AK6 production of diamonds either through open tender sales or exclusive contract, the removal of the commercial production start date and the mine lease area expanded.

As of the end of the 1st quarter of 2011, project execution is on schedule at overall 42% complete and 55% of the capital investment committed. Major operations contracts for mine operations and plant operations and maintenance are being adjudicated and ramp-up of Boteti manpower continues. All permits and licenses to operate are in place.

Mothae Diamond Project – Lesotho

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

Mothae Diamonds (PTY) Ltd ("Mothae Diamonds"), an indirect 75% owned subsidiary of the Company, holds a 100% interest in the Mothae project. The other 25% is owned by the Government of Lesotho. Mothae Diamonds Holdings Inc, an indirect wholly owned subsidiary of the Company, is the project operator. One half of the project interest held by the Government (i.e. 12.5% of the project interest) is a free carried interest and one half is funded by the Government through its share of project dividends.

In 2010, the Company commenced a trial mining program, based on results from the 100,000 tonne bulk sample completed in 2009. The trial mining program is designed to sample and process up to 720,000 tonnes of kimberlite from various kimberlite domains which have been identified within the pipe to confirm geological potential, the presence of the high value Type lla diamonds and achieve true price discovery through periodic diamond sales by open tender.

Prior to the initiation of trial mining significant modifications were made to the process plant to allow for recovery of large diamonds (up to approximately 40mm in diameter) and to minimize diamond breakage.

Following a competitive bidding process for mining and process plant operations, a mining contract was awarded to Lesotho based Thotanyana Mining and Civil Works and a plant operation contract was awarded to Lesotho based Minerals Operation Executive (Pty) Ltd. Key personnel in Lesotho have been recruited to manage the operations.

Test mining commenced in late May 2010 and continues. The upgraded process plant was commissioned using F domain kimberlite remaining on stockpile from the prior bulk sampling program and plant throughput achieved design capacity of 30,000 tonnes per month in August 2010. Mining and processing during the year was focused on the C domain kimberlite, which is currently interpreted to comprise the largest kimberlite domain of the Mothae pipe. In 2010, a total of 138,798 dry tonnes of kimberlite were processed resulting in recovery of 8,723 stones weighing 3,671 carats. As in the prior bulk sampling program, the bottom cut-off size for diamond recoveries is 2mm. In addition, a total of approximately 90,000 cubic meters of topsoil and residual overburden material have been stockpiled for processing at a later date.

To the end of December 2010, the Company has recovered a total 17,602 stones containing 7,538 carats during the 100,000 bulk sample and test mining phases. The diamonds recovered have been valued and classified as inventory based on weighted average valuations of US$492/ct used for the preparation of the Kingdom of Lesotho Kimberley Process Certificate and export to Antwerp where the diamonds were subsequently sold.

In March 2011, Mothae Diamonds held its first diamond sale by open tender of 9,381 cts and realized total proceeds of $8.18 million at an average of US$871/ct. Included in the sale were diamonds recovered subsequent to year end that had a higher weighted average valuation than those recovered prior to year end.

CHANGE OF YEAR END

In December 2009, the Company changed its financial year end from July 31 to December 31. As a result of the change, the Company has a five month transitional financial period ended December 31, 2009. This change was made to align the Company's reporting period with its subsidiaries.

SELECTED ANNUAL FINANCIAL INFORMATION

	Year ended December 31, 2010	Five months ended December 31, 2009	Year ended July 31, 2009
Statement of Operations Data			
Exploration Expenditures	$ 11,617,397	$ 591,370	$ 549,132
Operating Expenses	$ 4,455,697	$ 2,004,577	$ 1,198,955
Net Loss	$ 12,984,509	$ 12,809,199	$ 1,738,935
Data per Common Share			
Basic and Diluted Net Loss	$ 0.06	$ 0.12	$ 0.03
Balance Sheet Data			
Total Assets	$ 144,001,871	$ 143,872,879	$ 25,918,522
Long Term Liabilities	$ 5,959,417	$ 18,275,048	$ 3,759,982

RESULTS OF OPERATIONS

The Company's net loss for the twelve months ended December 31, 2010 was $12,984,509 or $0.06 per share compared to a net loss for the five months ended December 31, 2009 of $12,809,199 or $0.12 per share. The net loss for the twelve months ended July 31, 2009 was $1,738,935 or $0.03 per share.

The higher net loss for the current period as compared to the two prior periods presented is primarily due to increased expenditures relating to the trial mining program at Mothae and the costs associated with the feasibility study for the AK6 diamond project with no comparable amounts in the previous two reporting periods. In addition, the level of corporate activity has increased as the Company has grown period over period.

The operating losses are a reflection of the Company's status as a company which is developing diamond deposits and is not yet producing revenue. The Company currently has no main source of income although revenue is being generated through the sale of diamonds recovered during the trial mining program at Mothae. The Company's goal is to develop profitable diamond mining operations at both Mothae and Boteti AK6 and until this goal is achieved, losses are expected to continue.

Other comprehensive income reflects realized and unrealized gains derived from exchange rate changes on translation of cash balances in currency other than the US dollar and the unrealized gains/(loss) on the changes in the fair value of the marketable securities held at the end of the period.

SELECTED QUARTERLY FINANCIAL INFORMATION

Financial Data for 8 Quarters								
Three months Ended	**Dec-10**	**Sep-10**	**Jun-10**	**Mar-10**	**Two Months Dec-09**	**Oct-09**	**Jul-09**	**Apr-09**
A. Exploration Expenditures ($)	2,654,649	2,533,078	3,866,021	2,563,649	30,138	561,232	237,531	131,824
B. Operating Expenses ($)	1,821,642	815,455	890,353	928,247	1,579,908	424,669	508,025	180,090
C. Net loss ($)	2,075,509	2,976,618	4,627,617	3,304,765	11,853,194	956,005	760,442	311,820
D. Loss per share (basic and diluted) ($)	0.01	0.01	0.02	0.02	0.11	0.01	0.01	0.00

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

Exploration expenditures for the current quarter are primarily related to the test mining program that commenced in May 2010 at the Mothae diamond project offset by the value of diamonds recovered. In June 2010, a definitive feasibility study was completed on the Boteti A6K project and the project has been determined to be commercially feasible. Effective July 2010, pursuant to the Company's accounting policy for mineral properties, expenditures incurred on the Boteti AK6 diamond project have been capitalized.

The significant increase in exploration expenditures for the three months ended June 2010 as compared to the prior quarter is result of expenditures on the Boteti AK6 project that was acquired in late 2009 and increased activity on the Mothae diamond project in preparation for the test mining program.

The increase in the operating expenditures for the three months December 2010 relates to discretionary bonuses awarded and donations of US$250,000.

The significant increase in the operating expenditures for the two months ended December 31, 2009 as compared to the prior quarter is primarily a result of higher stock based compensation expense recognized and a donation of $589,995 to Lundin for Africa Foundation ("LFA"). LFA conducts two social programs in Lesotho.

The increase in net loss for the two months ended December 31, 2009 as compared to the prior quarter results from $9.8 million of guarantee fees incurred with respect to the Boteti AK6 acquisition.

LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2010, the Company had cash of $32.9 million and working capital of $27.2 million, as compared to cash of $49.1 million and working capital of $50.4 million as at December 31, 2009.

Net cash used in operating activities was $15.2 million for the year ended December 31, 2010. The use of cash was mainly driven by the loss for period $15.7 million comprised primarily of $11.6 million of exploration expenditures, offset by certain non-cash expenditures such as stock compensation of $1.1 million and depreciation of $1.4 million. Change in accounts receivable, rough diamond inventory and accounts payable balances account for the remainder of the cash usage in the period.

Cash from financing activities was $3.4 million and consisted of net proceeds of $0.6 million from the exercise of stock options and $2.8 million received from African Diamonds for portion of expenditures in Boteti.

Net cash used for investing activities was $5.4 million and consisted of $7.3 million received from African Diamonds on exercise of its option to increase its interest in Boteti. The proceeds were offset by expenditures of approximately $4.8 million incurred to upgrade the process plant and expansions at the Mothae diamond project; $6.5 million of development expenditures incurred on the Boteti AK6 project and $206,000 related to other.

The Company's existing funds as of December 31, 2010, the expected revenues from the sale of diamonds recovered from the Mothae project and the additional net proceeds of CAD$58 million from the private placement completed in February 2011 will not be sufficient to finance the anticipated expenditures of between US$120-US$130 million for the full development and construction of the AK6 mine, test mining program on the Mothae Project and general corporate expenses over the next twelve months. The timing and completion of these activities are conditional on additional funds being raised of approximately US$70-US$80 million either through equity or debt. The Company has entered into an exclusivity agreement whereby a lender has agreed to arrange funding between for the development of the Boteti AK6 diamond mine, subject to completion of due diligence and documentation.

There is no assurance that such financing will be available to the Company at the time and in the amount required or, if available, that it can be obtained on terms satisfactory to the Company.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements.

TRANSACTIONS WITH RELATED PARTIES

During the twelve ended December 31, 2010, the five months ended December 31, 2009 and the twelve months ended July 31, 2009, the Company incurred:

a) $349,416 (December 31, 2009 – $140,475, July 31, 2009 - $205,267) for administrative services and office facilities provided by a company owned by the Chairman of the Company. As at December 31, 2010, there was $15,962 (December 31, 2009 – $5,133, July 31, 2009 - $45,901) included in amounts due to related parties.

b) $Nil (December 31, 2009 – $589,995, July 31, 2009 - $45,901) for a donation to Lundin for Africa Foundation, a charitable organization with directors in common.

c) $639,472 (December 31, 2009 - $136,746, July 31, 2009 - $53,771) for generative exclusivity rights, laboratory services, professional fees, project, general and administrative services provided by a company with a director in common. As at December 31, 2010 there was $151,185 (December 31, 2009 - $28,465, July 31, 2009 - $107,824) included in amounts due to related parties.

d) As at December 31, 2009 there was $9,863,306 included in amounts due to related parties for guarantee fees payable to a significant shareholder of the Company. This amount was settled with shares in 2010.

e) $41,064 (December 31, 2009 - $79,689, July 31, 2009 - $Nil) for travel costs provided by a company associated with the Chairman of the Company. As at December 31, 2010 there was $Nil (December 31, 2009 - $79,689, July 31, 2009 - $Nil) included in amounts due to related parties.

These transactions, occurring in the normal course of operations, are measured at the exchange amount which is the amount established and agreed to by the related parties.

CHANGES IN ACCOUNTING POLICIES

In January 2009, the Canadian Institute of Chartered Accountants issued Section 1582 "Business Combinations", Section 1601 "Consolidated Financial Statements" and Section 1602 "Non-controlling interests".

Section 1582 replaces Handbook section 1581 "Business Combinations" and sections 1601 and 1602 together replace Handbook section 1600 "Consolidated Financial Statements". The adoption of section 1582 and collectively, 1601 and 1602 provides the Canadian equivalent to International Financial Reporting ("IFRS") 3 "Business Combinations" and International Accounting Standards (IAS) 27 "Consolidated and Separate Financial Statements", respectively.

CICA 1582 applies prospectively to 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, 2011. CICA 1601 and CICA 1602 apply to interim and annual consolidated financial statements relating to years beginning on or after January 1, 2011. The Company elected to early adopt these new rules for the reporting period beginning January 1, 2010. There was no material impact on the consolidated financial statements as a result of this adoption, except for changes in presentation of non-controlling interests.

INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

The Canadian Accounting Standards Board ("AcSB") has set January 1, 2011 as the date for publicly-listed companies to adopt IFRS, replacing Canadian GAAP. Accordingly, IFRS compliant financial statements for the Company will be required for the first quarter of 2011. Comparative figures presented in these financial statements are also required to comply with IFRS.

The Company's conversion plan consisted of three phases which are scoping and diagnostic, impact analysis and quantification, and implementation. During 2010, the IFRS conversion plan was substantially completed including the completion of illustrative December 31, 2011 year end and March 31, 2011 first quarter IFRS financial statements.

For 2011, the Company will finalize the impacts of the IFRS conversion adjustments on its 2011 financial statements including the preparation of the 2010 required comparative information. However, it is anticipated that the adjustments will not be material with the exception of the reversal of the January 1, 2010 future income tax liability of US$8.1 million against mineral properties and the reversal of the adjustments recorded under Canadian GAAP to this future income tax liability during 2010. The future income tax liability arose on prior asset acquisitions and such a purchase price bump up is not permitted under IFRS. The Company continues to assess the impact of foreign currency translation with regards to the functional currency of its subsidiaries. In addition, the Company will continue to assess the completeness and quality of the disclosures in the IFRS quarterly and annual financial statements.

The Company currently plans to make use of the following IFRS 1 elections on the adoption of IFRS:

- Cumulative translation adjustments ("CTA") – exemption that allows the Company to set its CTA to zero at date of transition.

- Business combinations – exemption is available within IFRS 1 that allows an entity to forward it previous GAAP accounting for business combinations prior to the transition date. This would include carrying forward balances based on methods of accounting (eg: acquisition of assets) that are not allowable under existing IFRS rules.

- Decommissioning liabilities included in the cost of mineral properties – This exemption relates to the retrospective application of changes in the decommissioning liabilities (Asset retirement obligation – "ARO") and the corresponding change in depreciation (applied prospectively). It allows entities on transition to determine what depletion of the ARO asset would have been based on the fair value under IFRS when the corresponding liability was incurred.

- Stock-based compensation – This exemption allows first-time adopters to not apply IFRS 2 to equity instruments that settled before the transition date.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to establish accounting policies and 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 2 to the consolidated financial statements for the twelve months ended December 31, 2010 includes a summary of the significant accounting policies adopted by the Company. The following policies are considered to be critical accounting policies since they involve the use of significant estimates.

Mineral Properties

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

The Company undertakes a periodic review of the carrying values of mineral properties and whenever events or changes in circumstances indicate that their carrying value may exceed their fair value. In undertaking this review, management of the Company is required to make significant estimates. These estimates are subject to various risks and uncertainties, which may ultimately have an effect on the expected recoverability of the carrying values of the mineral properties and related expenditures.

Income Taxes

Future income tax assets and liabilities are determined based on differences between the financial statement carrying values of assets and liabilities and their respective income tax bases ("temporary differences"), and losses carried forward. Future income tax assets and liabilities are measured using tax rates that are expected to be in effect when the temporary differences are likely to reverse. The effect on future income tax assets and liabilities of a change in tax rates included in operations in the period in which the change is substantively enacted. The amount of future income tax assets recognized is limited to the amount of the benefit that is more likely than not to be realized.

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

Stock Based Compensation

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

FINANCIAL INSTRUMENTS

The Company classifies financial instruments as either held-to-maturity, available-for-sale, held for trading, loans and receivables or other financial liabilities. The Company's financial instruments consist of cash and cash equivalents, marketable securities, accounts receivable, loans receivable, accounts payable and accrued liabilities and due to related parties. The carrying value of cash, marketable securities, accounts receivable and accounts payable approximates fair value.

Marketable securities are recorded at either fair value as determined by active market prices or measured at cost if there is no active quoted market price or recent sale.

OUTSTANDING SHARE DATA

As of April 18, 2011, there were 362,634,050 common shares and 11,410,000 stock options outstanding.

RISKS AND UNCERTAINTIES

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

Additional Funding Requirements

Further development and exploration of the various mineral projects in which the Company holds an interest depends upon the Company's ability to obtain financing through equity or debt financing, joint ventures or other means. While the Company has been successful in the past in obtaining financing through the sale of equity securities, there can be no assurance that the Company will be successful in obtaining additional financing in the amount and at the time required and, if available, that it can be obtained on terms satisfactory to the Company.

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

Uncertainties Related to Mineral Resource Estimates

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

Diamond Prices and Marketability

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

Currency Risk

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

Foreign Operations Risk

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

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

Mineral Exploration and Development

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

Title Matters

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

Infrastructure

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

Uninsured Risks

The mining business is subject to a number of risks and hazards including, but not limited to, environmental hazards, industrial accidents, labor disputes, encountering unusual or unexpected geologic formations or other geological or grade problems, encountering unanticipated ground or water conditions, cave-ins, pit wall failures, flooding, rock bursts, periodic interruptions due to inclement or hazardous weather conditions and other acts of God.

Such risks could result in damage to mineral properties or facilities, personal injury or death, environmental damage, delays in exploration, development or mining, monetary losses and possible legal liability. The Company maintains insurance against certain risks that are associated with its business in amounts that it believes to be reasonable at the current stage of operations. There can be no assurance that such insurance will continue to be available at economically acceptable premiums or will be adequate to cover any future claim.

Competition

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

Conflicts of Interest

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

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

FUTURE PLANS AND OUTLOOK

Mothae Project, Lesotho

- We intend to continue with the test mining program and will continue to process kimberlite at a rate of 30,000 tonnes per month through to the end of the first quarter of 2012.
- We expect to have completed an Environmental Impact Assessment by the third quarter of 2011
- We expect ongoing diamond recoveries and continued project evaluation for the duration of the test mining program.
- We anticipate further periodic sales of Mothae diamonds during 2011.

  We intend to commence a delineation drill program, of approximately 4,000 meters to extend the geological model to depth of 320 meters, in the second quarter of 2011,

AK6 Project, Botswana

- We intend to continue with the construction of the Phase I production facility, which includes a process plant and support facilities designed for an initial throughput of 2.5 million tonnes per year, with commissioning anticipated to commence in the fourth quarter of 2011 with full ramp up the first half of 2012.

- We intend to continue to ramp-up Boteti manpower to integrate with mine construction and commissioning.

- We expect to conclude and award the mining and process plant operator contracts and establish these resources on site to assist with commissioning and transition to operations during the first half of 2011.

- We intend to construct a sales and sorting office in Gaborone and have completed by the fourth quarter of 2011.

The Company will continue to evaluate other opportunities in the diamond sector for possible acquisition in order to position the Company for further growth.

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENT

Certain of the statements made and contained herein in the MD&A and elsewhere constitute forward-looking statements. Forward-looking statements are frequently, but not always, identified by words such as "expects", "anticipates", "believes", "intends", "estimates", "potential", "possible" and similar expressions, or statements that events, conditions or results "will", "may", "could" or "should" occur or achieved. Forward-looking statements involve 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 including, without limitation, exploration/drill results and budgets; capital expenditures; work programs; mineral reserve and resource estimates and the geology, grade and continuity of mineral deposits; diamond price and foreign currency fluctuations; uncertain political and economic environments; changes in laws or policies; the need to obtain financing and uncertainty as to the availability and terms of future financing; uncertainties involved in dispute or litigation and other risks and uncertainties describe under Risks and Uncertainties disclosed above. 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.

PRICEWATERHOUSECOOPERS

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Independent Auditor's Report

To the Shareholders of Lucara Diamond Corp.

We have audited the accompanying consolidated financial statements of Lucara Diamond Corp., which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of operations, comprehensive income and deficit, changes in shareholders' equity and cash flows for the year ended December 31, 2010 and the five months ended December 31, 2009 and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Lucara Diamond Corp. as at December 31, 2010 and 2009 and its results of operations and cash flows for the year ended December 31, 2010 and the five months ended December 31, 2009in accordance with Canadian generally accepted accounting principles.

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Other Matters

The consolidated financial statements of Lucara Diamond Corp. and its subsidiaries for the year ended July 31, 2009 were audited by another auditor who expressed an unmodified opinion on these statements on November 24, 2009.

Signed "PricewaterhouseCoopers LLP"

Chartered Accountants
April 18, 2011
Vancouver, BC

LUCARA DIAMOND CORP
CONSOLIDATED BALANCE SHEETS AS OF
(Expressed in United States Dollars)

	December 31, 2010	December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	$ 32,884,905	$ 49,123,926
Marketable securities (Note 5)	287,308	306,199
Loan receivable (Note 6)	-	2,000,000
Acounts receivable and other	1,542,948	298,665
	34,715,161	51,728,790
Rough Diamond Inventory	3,630,161	1,764,960
Plant and Equipment (Note 7)	16,471,241	1,500,000
Mineral Properties (Note 8)	88,979,003	88,879,129
Other Assets	206,305	-
TOTAL ASSETS	$ 144,001,871	$ 143,872,879
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	$ 7,284,929	$ 1,170,409
Due to related parties (Note 12)	167,147	113,287
	7,452,076	1,283,696
Long-term liabilities		
Due to related parties (Note 12)	-	9,863,306
Asset retirement obligations (Note 10)	567,697	360,641
Future income taxes (Note 13)	5,391,720	8,051,101
	5,959,417	18,275,048
TOTAL LIABILITIES	13,411,493	19,558,744
EQUITY		
Share capital (Note 11)	209,210,999	122,476,675
Contributed surplus (Note 11(c))	4,154,424	1,649,157
Deficit	(84,384,456)	(15,595,964)
Accumulated other comprehensive income	1,609,411	640,225
Total equity attributable to equity holders of the parent	130,590,378	109,170,093
Non-controlling interests (Note 4)	-	15,144,042
TOTAL EQUITY	130,590,378	124,314,135
TOTAL LIABILITIES AND EQUITY	$ 144,001,871	$ 143,872,879

Commitments - Note 16
Contingencies - Note 17
Subsequent event - Note 18

Approved by the Board:

/s/Paul K. Conibear
Director

/s/William Lamb
Director, President and CEO

See accompanying notes to the consolidated financial statements

LUCARA DIAMOND CORP
CONSOLIDATED STATEMENTS OF OPERATIONS
(Expressed in United States Dollars)

	For the Year Ended December 31, 2010	Five Months Ended December 31, 2009	For the Year Ended July 31, 2009
Exploration expenditures (Note 9)	$ 11,617,397	$ 591,370	$ 549,132
Operating expenses			
Stock based compensation (Note 11(c))	1,085,784	563,307	399,227
Salaries & benefits	1,226,943	355,278	263,640
Management fees	349,416	140,475	205,267
Professional fees	492,675	128,157	143,652
Stock exchange, transfer agent, shareholder communication	241,498	55,641	58,024
Travel	667,214	126,200	52,810
Office and general	124,767	45,524	30,435
Donations	267,400	589,995	45,901
	4,455,697	2,004,577	1,198,955
Loss before the following	16,073,094	2,595,947	1,748,087
Guarantee fees (Note 12)	-	9,863,306	-
Interest income	(454,750)	(31,116)	(24,720)
Foreign exchange loss/(gain) realized	563,165	381,062	15,569
Loss before income taxes	$ 16,181,509	$ 12,809,199	$ 1,738,935
Income taxes (Note 13)	(3,197,000)	-	-
Net loss for the period	$ 12,984,509	$ 12,809,199	$ 1,738,935
Loss for the period attributable to:			
Non-controlling interests	$ 1,613,294	$ -	$ -
Equity holders of the parent	11,371,215	12,809,199	1,738,935
	$ 12,984,509	$ 12,809,199	$ 1,738,934
Basic and diluted loss per common share	$ 0.06	$ 0.12	$ 0.03
Weighted average number of common shares outstanding	223,734,936	108,556,258	66,401,035

See accompanying notes to the consolidated financial statements

LUCARA DIAMOND CORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in United States Dollars)

	For the Year Ended December 31, 2010	Five Months Ended December 31, 2009	For the Year Ended July 31, 2009
Cash flows from/(used in):			
Operating activities			
Net Loss for the period	$ (12,984,509)	$ (12,809,199)	$ (1,738,935)
Items not affecting cash:			
Future income tax recoverable	(3,197,000)	-	-
Stock based compensation expense	1,085,784	563,307	399,227
Guarantee fees	-	9,863,306	-
Interest receivable	(186,066)	-	-
Accretion and depreciation	1,395,815	41,551	986
Unrealized foreign exchange loss/(gain)	606,122	-	-
Net changes in non-cash working capital items:			
Amounts receivable and other current assets	(1,244,283)	932	85,488
Rough diamonds	(1,865,201)	-	-
Accounts payable and other current liabilities	1,212,881	377,535	(219,386)
	(15,176,457)	(1,962,568)	(1,472,620)
Financing activities			
Proceeds from minority interest	2,808,825	-	-
Shares issued for cash (net of issue costs)	587,624	99,039,472	4,681,844
	3,396,449	99,039,472	4,681,844
Investing activities			
Plant and equipment	(11,372,878)	-	-
Proceeds from option exercised	7,356,256	-	-
Net cash (paid)/received on acquisition	(1,224,163)	(48,457,254)	2,115,162
Mineral property expenditures	-	-	(4,172,860)
Loan advanced	-	(2,000,000)	
Other assets	(206,305)	-	-
	(5,447,090)	(50,457,254)	(2,057,698)
Increase (decrease) in cash and cash equivalents	(17,227,098)	46,619,650	1,151,526
Effect of exchange rate changes on cash and cash equivalents	988,077	453,553	(409,239)
Cash and cash equivalents, beginning of the period	49,123,926	2,050,723	1,308,436
Cash and cash equivalents, end of the period	$ 32,884,905	$ 49,123,927	$ 2,050,723
Supplemental Information:			
Cash received for interest	$ 268,684	$ 31,116	$ 24,720
Cash paid for income taxes	$ -	$ -	$ -
Changes in accounts payable and accrued liabilities related to plant and equipment additions	$ 4,955,499	$ -	$ -

See accompanying notes to the consolidated financial statements

LUCARA DIAMOND CORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Expressed in United States Dollars)

	For the Year Ended December 31, 2010	Five Months Ended December 31, 2009	For the Year Ended July 31, 2009
Net loss for the period	$ 12,984,509	$ 12,809,199	$ 1,738,935
Other comprehensive income/(loss)			
Unrealized gain(loss) on marketable securities available-for-sale	(18,891)	251,246	3,944
Unrealized foreign exchange gain/(loss) on net assets denominated in other than the US dollar	988,077	453,553	(409,239)
	969,186	704,799	(405,295)
Comprehensive loss for the period	$ 12,015,323	$ 12,104,400	$ 2,144,230
Total comprehensive Loss for the period attributable to:			
Non-controlling interests	$ 1,613,294	$ -	$ -
Equity holders of the parent	10,402,029	12,104,400	2,144,230
	$ 12,015,323	$ 12,104,400	$ 2,144,230

LUCARA DIAMOND CORP
CONSOLIDATED STATEMENTS OF DEFICIT
(Expressed in United States Dollars)

	For the Year Ended December 31, 2010	Five Months Ended December 31, 2009	For the Year Ended July 31, 2009
Deficit, beginning of the period	$ 15,595,964	$ 2,786,765	$ 1,047,830
Loss for the period attributable to equity holders of the parent	11,371,215	12,809,199	1,738,935
Disposition of a portion of non-controlling interest in Boteti Mining (PTY) Ltd Note 4(b)	(2,126,918)	-	-
Excess paid to acquire non-controlling interest in Boteti Mining (PTY) Ltd Note 4 (c)	59,544,195	-	-
Deficit, end of the period	$ 84,384,456	$ 15,595,964	$ 2,786,765

See accompanying notes to the consolidated financial statements

1. NATURE AND CONTINUANCE OF OPERATIONS

Lucara Diamond Corp. ("the Company") is a development stage company focused on diamond properties in Africa. The Company holds an indirect 100% interest in the AK6 Diamond Project located in Botswana, a 75% indirect interest in the Mothae Diamond Project located in Lesotho and 10 exploration licenses in Namibia.

In the fourth quarter of 2010, the Company commenced construction of a mine on the AK6 Diamond Project upon completion of development activities and the feasibility study. At the Mothae Diamond Project, the Company is conducting a trial mining program.

The recoverability of the amounts shown as mineral property acquisition costs is dependent upon discovery of sufficient economically recoverable ore reserves, preservation of the Company's interest in the mineral properties, the ability of the Company to obtain financing necessary to complete development of properties and to achieve future profitable production, or upon the Company's ability to dispose of its interest on an advantageous basis. Changes in future conditions could require material write downs of the carrying amount of the properties.

The mineral properties are also subject to title and sovereign risks, including political and economic instability, government regulations relating to mining, military repression, civil disorder, currency fluctuations and inflation, all or any which may impede the Company's activities or may result in the impairment or loss of part or all of the Company's interest in the properties.

2. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of presentation

In December 2009, the Company changed its financial year end from July 31 to December 31. As a result of the change, the Company has a five month transitional financial period ended December 31, 2009. This change was made to align the Company's reporting periods with its subsidiaries.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. They include the accounts of the Company, its wholly-owned subsidiaries, Motapa Diamonds Inc, Motapa Exploration Limited, Kavango Diamond Company (Pty) Ltd, Lucara Diamond Holdings (I) Inc., Boteti Mining (PTY) Ltd, African Diamonds (Plc), Lucara South Africa (PTY) (formerly Gondwana Diamonds (PTY)), and its 75% interest in Mothae Diamond Proprietary Limited.

b) Use of estimates

Preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities on a going concern basis, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of expenses during the reporting periods. Actual results could differ from these estimates.

Significant areas requiring use of management estimates include determination of reclamation obligations, recoverability of the capitalized costs on mineral properties and other long-lived assets, and assumptions used in determining fair value of stock based compensation and future income tax assets or liabilities. Actual results could differ from those estimates.

c) Changes in Accounting Policies

Sections 1582 "Business Combinations", Section 1601 "Consolidated Financial Statements" and Section Section 1602 "Non-controlling Interests". Section 1582 replaces Handbook Section 1581 "Business Combinations" and sections 1601 and 1602 together replace Handbook section 1600 "Consolidated Financial Statements". The adoption of section 1582, and collectively, 1601 and 1602 provides the Canadian equivalent to International Financial Reporting Standard ("IFRS") 3 "Business Combinations" and International Accounting Standards (IAS) 27 "Consolidated and Separate Financial Statements", respectively.

CICA 1582 applies prospectively to 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, 2011. CICA 1601 and CICA 1602 apply to interim and annual consolidated financial statements relating to years beginning on/after January 1, 2011.

The Company has early adopted these new rules effective January 1, 2010 for the fiscal year ending December 31, 2010. There was no material impact on the consolidated financial statements as result of this adoption, except for changes presentation of non-controlling interests.

d) Cash and cash equivalents

Cash and cash equivalents includes highly liquid short-term investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value.

e) Marketable securities

Marketable securities consist of common shares of a public company, are classified as available –for-sale and are reported at quoted market value. Adjustments to market value are made, with the offsetting debit or credit taken into to other comprehensive income/loss.

f) Rough diamond inventory

Diamonds are valued at lower of cost and net realizable value.

g) Plant and Equipment

Plant and equipment are recorded at cost less accumulated depreciation. Repairs and maintenance expenditures are charged to operations; major improvements and replacements which extend the useful life of an asset are capitalized. Depreciation of plant and equipment begins when assets are substantially put into service. Mine and plant facilities with same useful life as the related mineral property will be amortized on a unit-of-production method based upon the expected life of mine plan, once established. The test mining plant facilities are being amortized on a unit of production based on the amount of ore to be processed during the test mining phase and residual value of the related equipment. Other equipment is depreciated on a straight-line basis, net of residual value, over the estimated useful life of the asset.

h) Mineral properties

Costs related to the acquisition of mineral properties are capitalized on a property-by-property basis. Exploration expenditures, net of recoveries, are expensed as incurred. When it has been established that a mineral deposit is commercially mineable and an economic analysis has been completed, the costs subsequently incurred to develop a mine on the property prior to the start of mining operations are capitalized, When there is little prospect of further work on a property being carried out by the Company, when a property is abandoned, or when the capitalized costs are no longer considered recoverable, property costs are written down to management's estimate of the net recoverable amount. Costs related to a property from which there is production, together with costs of production equipment, will be depleted and amortized on a unit-of-production method based upon the expected life of mine plan, once established.

A mineral property acquired under an option where payments are to be made at the sole discretion of the Company, are capitalized at the time of payment.

i) Impairment of long-lived assets

The Company assesses the possibility of impairment in the net carrying value of its long-lived assets when events or circumstances indicate that carrying amounts of the asset or asset group may not be recoverable. Management calculates the estimated undiscounted future net cash flows relating to the asset or asset group using estimated future prices, proven and probable reserves and other mineral resources, and operating, capital and reclamation costs. When the carrying value of an asset exceeds the related undiscounted cash flows, the asset is written down to its estimated fair value, which is usually determined using discounted future cash flows. Management's estimates of mineral prices, mineral resources, foreign exchange, production levels and operating capital and reclamation costs are subject to risk and uncertainties that may affect the determination of the recoverability of the long-lived asset. It is possible that material changes could occur that may adversely affect management's estimates.

j) Asset retirement obligations

The Company recognizes a liability for an asset retirement obligation on long-lived assets when a legal liability exists and the amount of the liability is reasonably determinable. Asset retirement obligations are calculated on discounted future payment estimates and the liability is accreted over the expected term of the obligation. Subsequent adjustments to the estimates, due to changes in the underlying assumptions, are made on a prospective basis. Corresponding amounts and adjustments are added to the carrying value of the related long-lived asset and amortized or depleted to operations in accordance with accounting policy.

k) Environmental costs

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

Generally, the timing of these accruals coincides with the earlier of completion of a feasibility study or the Company's commitment to a plan of action based on the then known facts. The Company intends to comply with all environmental regulations. Presently, the Company has not received any communication from regulatory authorities.

l) Income taxes

Income taxes are calculated using the asset and liability method of accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets at substantially enacted income tax rates. Future tax assets are recognized to the extent that they are considered more likely than not to be realized. Valuation allowances are provided when unrecognized net future income tax assets are not more likely than not to be realized.

m) Loss per share

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

n) Stock based compensation

The Company has a stock option plan that is described in Note 11(c). The Company uses the fair value method of recognizing all stock-based compensation awards including those made to employees, consultants, officers and directors of the Company.

Except for those options having a performance clause attached, the fair value of stock options granted is determined on the grant date and that fair value is credited to contributed surplus on the grant date if the options vest immediately, or over the vesting period if the options do not vest immediately. Those options having a performance clause are revalued at each vesting or performance date and the fair value of the earned options is credited to contributed surplus on the date earned. The fair value of stock options exercised will be transferred to share capital and the fair value of stock options that expire unexercised, remains in contributed surplus.

o) Financing charges

Finance costs are netted against the carrying value of the liability on the consolidated balance sheet and amortized to operations using the effective interest rate method over the expected life of the related liability.

p) Foreign currency translation

The US dollar is the reporting currency of the Company.

Assets and liabilities of self-sustaining operations which are denominated in a currency other than US dollars are translated at year-end exchange rates, and revenues and expenses are translated at average exchange rates. Differences arising from these foreign currency translations are reported as other comprehensive income.

For integrated operations, monetary assets and liabilities are translated at year-end exchange rates and non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at average exchange rates, except for items related to non-monetary assets and monetary liabilities are charged to earnings.

q) Financial instruments

The Company classifies financial instruments as either held-to-maturity, available-for-sale, held for trading, loans and receivables or other financial liabilities. At the respective balance sheet dates, the Company's financial instruments consisted of cash and cash equivalents, marketable securities, accounts receivable, loans receivable, accounts payable and accrued liabilities and due to related parties.

Financial assets held-to-maturity, loans and receivables and financial liabilities other than those held for trading, are measured at amortized cost. Available-for-sale instruments are measured at fair value with the unrealized gains and losses recognized in other comprehensive income. Instruments classified as held for trading are measured at fair value with the unrealized gains and losses recognized in the statement of operations.

The following is a summary of the categories the Company has elected to apply to each of its significant financial instruments.

Financial instrument	**Category**
Cash and cash equivalents	Available for sale
Marketable securities	Available for sale
Accounts receivable	Loans and receivables
Loans receivable	Loans and receivables
Accounts payable and accrued liabilities	Other financial liabilities
Due to related parties	Other financial liabilities

CICA Handbook section 3862 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair values. The Company's financial instruments as at December 31, 2010 classified as "Level One – Quoted prices in active markets" are cash and cash equivalents and marketable securities.

r) Future accounting changes

Canadian GAAP for publicly listed companies will be replaced by International Financial Reporting Standards ("IFRS"), effective for interim and annual periods beginning in the first quarter of fiscal 2011. The Company's annual and interim fiscal 2011 consolidated financial statement will include an IFRS opening consolidated balance sheet as at January 1, 2010, fiscal 2011 comparatives, related transitional reconciliation and note disclosures.

3. ACQUISITION OF MOTAPA DIAMONDS INC

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

The net assets acquired on the acquisition of Motapa are not considered to meet the definition of a business under Emerging Issues Abstract 124, as published by the Canadian Institute of Chartered Accountants; accordingly, the acquisition had been accounted for as a purchase of assets and liabilities. The purchase price allocation is summarized as follows:

Purchase price:	
Share issued on acquisition (34,455,022 shares)	$13,445,728
Fair value of replacement options issued	193,775
Acquisition costs	263,959
	$13,903,462
Net assets acquired	
Cash and cash equivalents	$ 2,379,121
Accounts receivable and prepaid expenses	291,036
Marketable securities	51,006
Diamond inventory	1,529,937
Plant and equipment	1,500,000
Mineral properties	12,345,479
Accounts payable and accrued liabilities	(626,135)
Asset retirement obligations	(127,409)
Future income tax liability	(3,439,573)
	$13,903,462

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

For the year ended July 31, 2009

Cash acquired on acquisition	$ 2,379,121
Cash paid for transaction costs	(263,959)
Net cash received from the acquisition	$ 2,115,162

4. ACQUISITION OF BOTETI MINING (PTY) LIMITED, DEBWAT EXPLORATION (PTY) LTD AND AFRICAN DIAMONDS (PLC)

a) In December 2009, the Company, through a newly created indirect wholly-owned subsidiary Boteti Diamond Holdings Inc. ("Boteti Holdings") acquired an initial 70.268% interest in the Boteti Mining (PTY) Ltd. ("Boteti"), which holds a 100% interest in the AK6 project from De Beers Prospecting Botswana (Pty) Limited ("De Beers") for consideration of $49 million. The remaining interest in Boteti was held as to 28.381% by African Diamonds PLC ("African Diamonds") and indirectly by Wati Ventures (Pty) Ltd. ("Wati Ventures") as to 1.351%. Boteti Holdings had granted an option to African Diamonds to increase its interest in Boteti by a further 10.268% by making a cash payment of approximately US$7.3 million (Refer to Note 4b).

To fund the AK6 acquisition, Lucara and Boteti Holdings had entered into a guarantee and loan facility with a significant shareholder of the Company in the amount of $49.0 million. As consideration for the guarantee, the lender was entitled to receive 12,191,200 shares in the Company. The shares were issued in 2010 at a fair value of $9.8 million.

The net assets acquired on the acquisition of Boteti are not considered to meet the definition of a business under Emerging Issues Abstract 124, as published by the Canadian Institute of Chartered Accountants; accordingly, the acquisition had been accounted for as a purchase of assets and liabilities. The purchase price allocation is summarized as follows:

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

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

For the five months ended July 31, 2009

Cash paid on acquisition	$49,000,000
Cash paid for transaction costs	623,992
Cash received on acquisition	(1,166,738)
Net cash paid on acquisition	$48,457,254

b) In April 2010, African Diamonds exercised its option to acquire the 10.268% of the Company's interest in Boteti in consideration of a cash payment of $7,356,256. The value of the non-controlling interest in Boteti that was disposed of was $5,229,338. In accordance with Section 1602, this transaction has been accounted for as an equity transaction. The $2,126,918 received in excess of the non-controlling interest has been recorded as an adjustment to the Deficit.

After the exercise of the option, Boteti was held 60% by the Company and 40% by African Diamonds.

c) In December 2010, the Company acquired African Diamonds' non-controlling interest in Boteti for consideration of 80,245,726 common shares of the Company on the basis of 0.80 ("Ratio") of a common share of the Company in exchange for every one common share in the capital of African Diamonds. In addition, the Company issued a total of 6,640,000 replacement stock options to African Diamonds stock option holders. At the time of acquisition all other assets of African Diamonds, other than its interest in Boteti, the loan payable to the Company (Note 6) and legal proceedings relating to AK6 diamond project were transferred into a newly formed company which is owned by the former African Diamond shareholders. The loan between the Company and African Diamonds has been eliminated on consolidation and is part of the consideration paid.

In accordance with Section 1602, this transaction has been accounted for as an equity transaction and $59,544,195 has been recorded as an adjustment to the Deficit as follows:

Consideration:

Fair value of shares issued	$76,127,684
Fair value of options issued	1,575,193
Elimination of loan and interest	2,186,068
Transaction costs	1,224,163
Sub-total	81,113,108
Less: non-controlling interest	21,568,913
Excess to Deficit	$59,544,195

5. MARKETABLE SECURITIES

	December 31, 2010	December 31, 2009
Fair value – beginning of the period	$ 306,199	$ 54,953
Unrealized gain/(loss) on available-for-sale investments	(18,891)	251,246
Fair value – end of the period	$ 287,308	$ 306,199

6. LOAN RECEIVABLE

In November 2009, the Company provided a $2.0 million convertible loan to African Diamonds, which had an interest rate of 8%, to fund its portion of an updated feasibility study and general working capital purposes.

As a result of the acquisition of African Diamonds the loan receivable is eliminated on consolidation (Refer to Note 4(c)).

7. PLANT AND EQUIPMENT

December 31, 2010

	Cost	Accumulated Depreciation	Net
Plant facilities and equipment	$ 6,651,297	$ (1,357,136)	$ 5,294,161
Construction in progress	11,177,080	-	11,177,080
	$ 17,828,377	$ (1,357,136)	$ 16,471,241

December 31, 2009

	Cost	Accumulated Depreciation	Net
Plant facilities and equipment	$ 1,500,000	$ -	$ 1,500,000

The plant facilities and equipment at the Mothae diamond project were put back into service when the trial mining program commenced in the second half of 2010.

8. MINERAL PROPERTIES

	December 31, 2010	December 31, 2009	July 31, 2009
Mothae Diamond Project - Acquisition	$ 20,356,432	$ 20,356,432	$ 20,356,432
Mothae Diamonds Project – Asset retirement obligation	292,874	193,000	193,000
AK Diamond Project – Acquisition (Note 4a)	68,329,697	68,329,697	-
	$ 88,979,003	$ 88,879,129	$20,549,432

a) Mothae Diamond Project - Lesotho

In July 2006, the Company signed an option agreement with Motapa Diamonds Inc. ("Motapa") to acquire up to a 70% interest in the Mothae Diamond Project located in Lesotho, Africa. Pursuant to the terms of the option agreement the Company had earned a 65% in the property in April 2009 by making payments to Motapa totaling $8.0 million. During the year ended July 31, 2009, the Company acquired the remaining 35% as part of the plan of arrangement with Motapa (Note 3) and capitalized an additional $12.3 million of mineral property acquisition costs.

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

b) AK6 Diamond Project - Botswana

Boteti was granted a 15 year diamond mining lease over the Boteti AK6 diamond project in October 2008. A royalty of 10% of the sales value of the diamonds produced from Boteti AK6 will be payable to the Government of the Republic of Botswana.

c) Kavango Project – Namibia

The Company has a 100% interest in 10 Exclusive Prospecting Licenses for precious stones in northeast Namibia. Namdeb Diamond Corporation ("Namdeb") has the right to earn a 51% interest by committing to fund a work program of approximately $4.4 million by December 2011. The agreement provides Namdeb with a second option to earn an additional 14% interest (for a total of 65%) by fully funding the project to completion of a bankable feasibility study within five years of electing to exercise its second option.

9. EXPLORATION EXPENDITURES

	Mothae Project Lesotho	Boteti AK6 Project Botswana	Other	Total
For the twelve months ended December 31, 2010				
Test mining	$ 7,319,740	$ -	$ -	$ 7,319,740
Feasibility study	-	2,669,553	-	2,669,553
Relocation of core samples, tailings and concentrates	-	514,494	-	514,494
Geology	414,803	-	-	414,803
Depreciation and accretion	1,395,815	-	-	1,395,815
Office and other	447,014	476,238	24,825	948,077
Rough diamonds recovered	(1,645,085)	-	-	(1,645,085)
Total for the period	**$ 7,932,287**	**$ 3,660,285**	**$ 24,825**	**$ 11,617,397**

	Mothae Project Lesotho	Boteti AK6 Project Botswana	Other	Total
For the five months ended December 31, 2009				
Site and administration	$ 302,975	$ -	$ -	$ 302,975
Pipe evaluation and test mining	43,195	-	-	43,195
Licenses fees	88,999	-	-	88,999
Accretion	40,233	-	-	40,233
Office and other	16,948	1,046	74,324	92,318
Project investigation	-	-	23,650	23,650
Total for the period	**$ 492,350**	**$ 1,046**	**$ 97,974**	**$ 591,370**

	Mothae Project Lesotho	Boteti AK6 Project Botswana	Other	Total
For the twelve months ended July 31, 2009				
Site and administration	$ 120,828	$ -	$ -	$ 120,828
Pipe evaluation and test mining	25,398	-	-	25,398
Conceptual studies and valuations	273,461			273,461
Licenses fees	-	11,255	-	11,255
Office and other	5,973	18,042	3,115	27,130
Project investigation	-	-	91,060	91,060
Total for the period	**$ 425,660**	**$ 29,297**	**$ 94,175**	**$ 549,132**

10. ASSET RETIREMENT OBLIGATIONS

The Company has restoration and remediation obligations associated with its diamond projects. The Company has calculated the fair value of its asset retirement obligation using a credit adjusted rate of 13.50% and an inflation rate of 8% for each of the periods ended December 31, 2010 and 2009 and July 31, 2009. The estimated total liability for reclamation and remediation costs on an undiscounted basis after inflation is approximately $3.2 million (December 31, 2009 - $1.7 million, July 31, 2009 – $1.7 million), which is expected to commence in 2023.

	December 31, 2010	December 31, 2009	July 31, 2009
Balance, beginning of period	$ 360,641	$ 320,409	$ -
Obligations acquired (Note 3)	-	-	127,409
Obligations incurred	99,874	-	193,000
Accretion of the liability	38,679	40,232	-
Changes in exchange rate	68,503	-	-
	$ 567,697	$360,641	$320,409

11. SHARE CAPITAL

(a) Authorized:

Unlimited number of common shares without par value.

(b) Issued:

	Number of Shares	Share Capital	Contributed Surplus
Balance, July 31, 2008	58,430,665	$ 5,271,241	$531,238
Private placement, net	5,555,556	4,681,844	-
Issued for 100% of Motapa (Note 3)	34,455,022	13,445,728	193,775
Stock based compensation	-	-	399,227
Balance, July 31, 2009	98,441,243	$ 23,398,813	$1,124,240
Options exercised	326,924	156,643	-
Fair value of options exercised	-	38,390	(38,390)
Private placement, net	110,000,000	98,882,829	-
Stock based compensation	-	-	563,307
Balance, December 31, 2009	208,768,167	$122,476,675	$1,649,157
Shares issued for guarantee (Note 4(a))	12,191,200	9,863,306	-
Options exercised	1,108,957	587,624	-
Fair value of options exercised	-	155,710	(155,710)
Issued for 100% of African Diamonds (Note 4(c))	80,425,726	76,127,684	1,575,193
Stock based compensation	-	-	1,085,784
Balance, December 31, 2010	302,494,050	$209,210,999	$4,154,424

In December 2009, the Company completed a private placement of 110,000,000 common shares at a price of CAD$1.00 per share of gross proceeds of CAD$110.0 million. A fee of 5% was paid on a portion of the private placement.

In August 2008, the Company completed a non-brokered private placement of 5,555,555 common shares at a price of CAD$0.90 per share for gross proceeds of CAD$5.0 million.

(c) Stock Options:

The Company has a rolling stock option plan, approved by shareholders on February 19, 2010, reserving an aggregate of 10% of the issued and outstanding shares of the Company for issuance upon the exercise of the options granted. Terms and vesting of the option granted are at the discretion of the Board of Directors at the time of grant.

Incentive stock options outstanding and held by directors, officers and employees of the Company are as follows:

	Number of Options	Weighted Average Exercise price – CAD$
Outstanding – July 31, 2008	910,000	$1.18
Granted	4,919,835	0.76
Exercised	-	-
Expired/Forfeited	(229,209)	0.87
Outstanding – July 31, 2009	5,600,626	$0.83
Granted	1,835,000	1.00
Exercised	(326,924)	0.51
Expired	(1,403,920)	1.38
Outstanding-December 31,2009	5,704,782	$0.76
Granted	7,840,000	0.95
Exercised	(1,108,957)	0.56
Expired/Forfeited	(885,825)	0.77
Outstanding – December 31, 2010	11,550,000	$0.91
Exercisable	9,503,954	$0.94

The fair values of stock options with vesting provisions are amortized as stock-based compensation expense over the applicable vesting period. As of December 31, 2010, the Company had an additional $535,584 (December 31, 2009 - $983,110, July 31, 2009 - $407,276) of stock based compensation expense to be recognized in the Statement of Operations and Comprehensive Income over the applicable vesting period of the related options.

The stock based compensation was estimated using the Black-Scholes option-pricing model. Assumptions used in the pricing model for options granted are as follows:

	December 31, 2010	**December 31, 2009**	**July 31, 2009**
Dividend yield	0.00%	0.00%	0.00%
Average risk free interest rate	1.68%	1.06%	1.37%
Expected stock price volatility	58.48%	112.51%	106.61%
Expected life of options	1.76 years	3 years	1.47 years

The weighted average grant-date fair value of stock options granted in the year ended December 31, 2010 was $0.29 per option (December 31, 2009 - $0.63, July 31, 2009 - $0.16).

The following summarizes the stock options outstanding as at December 31, 2010:

Range of Exercise Prices (CDN$)	Outstanding Options: Number of Options Outstanding	Outstanding Options: Weighted Average Remaining Contractual Life (Years)	Outstanding Options: Weighted Average Exercise Price	Exercisable Options: Number of Options Exercisable	Exercisable Options: Weighted Average Remaining Contractual Life (Years)	Exercisable Options: Weighted Average Exercise Price
$0.00 - $0.49	1,525,000	1.52	$ 0.48	1,010,655	1.51	$ 0.48
$0.50 - $0.99	6,350,000	1.60	0.84	5,563,308	1.44	0.83
$1.00 - $1.49	2,675,000	1.85	1.11	1,929,991	1.80	1.15
$1.50 - $1.99	800,000	1.47	1.56	800,000	1.47	1.56
$2.00 - $2.50	200,000	1.47	2.08	200,000	1.47	2.08
	11,550,000	1.64	$ 0.91	9,503,954	1.53	$ 0.94

12. RELATED PARTY TRANSACTIONS

During the twelve months ended December 31, 2010, the five months ended December 31, 2009 and the twelve months ended July 31, 2009 the Company incurred:

a) $349,416 (December 31, 2009 – $140,475, July 31, 2009 - $205,267) for administrative services and office facilities provided by a company owned by the Chairman of the Company. As at December 31, 2010, there was $15,962 (December 31, 2009 – $5,133, July 31, 2009 - $1,010) included in amounts due to related parties.

b) $Nil (December 31, 2009 – $589,995, July 31, 2009 - $45,901) for a donation to Lundin for Africa Foundation, a charitable organization with directors in common.

c) $639,472 (December 31, 2009 - $136,746, July 31, 2009 - $53,771) for generative exclusivity rights, laboratory services, professional fees, project, general and administrative services provided by a company with a director in common. As at December 31, 2010 there was $151,185 (December 31, 2009 - $28,465, July 31, 2009 - $107,824) included in amounts due to related parties.

d) As at December 31, 2009 there was $9,863,306 included in amounts due to related parties for guarantee fees payable to a significant shareholder of the Company. This amount was settled with shares in 2010.

e) $41,064 (December 31, 2009 - $79,689, July 31, 2009 - $Nil) for of travel costs provided by a company associated with the Chairman of the Company. As at December 31, 2010 there was $Nil (December 31, 2009 - $79,689, July 31, 2009 - $Nil) included in amounts due to related parties.

These transactions, occurring in the normal course of operations, are measured at the exchange amount which is the amount established and agreed to by the related parties.

13. INCOME TAXES

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

	Year Ended December 31, 2010	Five Months Ended December 31, 2009	Year Ended July 31, 2009
Basic statutory tax rate	28.5%	30%	31%
Net loss before taxes	16,181,509	12,809,199	1,738,933
Computed income tax recovery	$4,611,000	$3,843,000	$ 539,000
Differences between Canadian and foreign tax rates	(418,000)	(39,000)	(46,000)
Non-deductible expenses	(309,000)	(177,000)	(124,000)
Change in tax rates	(75,000)	(1,011,000)	-
Change in valuation allowance for the year	(1,920,000)	(2,616,000)	(369,000)
Losses acquired	1,221,000	-	-
Exchange rate differences	87,000)	-	-
Future income tax recovery	$ 3,197,000	$ -	$ -

Future income taxes result primarily from temporary differences in the recognition of certain revenue and expense items for financial and income tax reporting purposes. The approximate tax effect of temporary differences that gives rise to the Company's future income tax assets and liabilities are as follows:

Future income tax assets	December 31, 2010	December 31, 2009	July 31, 2009
Non-capital loss carried forward	$ 3,927,757	$ 2,259,719	$ 1,951,307
Resource pools	50,239	50,782	150,734
Share issue, finance costs and other	3,861,755	3,608,988	86,521
Less: valuation allowance	(7,839,751)	(5,919,490)	(2,188,562)
Future Tax Assets	$ -	$ -	$ -
Future income tax liabilities			
Mineral property acquisition costs	$ 5,391,720	$ 8,051,101	$3,439,573
Future Tax Liabilities	$ 5,391,720	$ 8,051,101	$3,439,573

As at December 31, 2010, the Company has non-capital losses for income tax purposes in Canada available to offset future taxable income of approximately CAD$11,041,000 (December 31, 2009 - CAD$7,884,000, July 31, 2009 – CAD$7,064,000). These losses, if not utilized, will expire through to 2030. Future tax benefits which may arise as a result of these non-capital losses have not been recognized in these financial statements and have been offset by a valuation allowance.

14. CAPITAL DISCLOSURES

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 shareholders' equity to be capital.

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

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

The Company's existing current capital resources will be not be sufficient to finance the anticipated expenditures for the full development and construction of the AK6 mine, test mining program on the Mothae Project and general corporate expenses over the next twelve months. The timing and completion of these activities are conditional on additional funds being raised either through equity or debt.

15. MANAGEMENT OF FINANCIAL RISK

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

a) Currency risk

The Company is exposed to the financial risk related of fluctuating foreign exchange rates. The operating results and financial position of the Company are reported in US dollars. The fluctuation of the Canadian dollar, Lesotho Maluti, Botswana Pula and South African Rand in relation to the US dollar will consequently have an impact on the financial results of the Company and will also affect the Company's assets, liabilities and shareholders' equity. The Company has not hedged its exposure to currency fluctuations.

At December 31, 2010, the Company is exposed to currency risk relating to funds held in Canadian dollars of $25.7 million and South African Rand of 13.0 million. Based on this exposure, a 1% change in the Canadian/US dollar and Pula/US dollar exchange rate would give rise to an increase/decrease of approximately $275,000 in Other Comprehensive Income.

b) Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The majority of the Company's cash is held through a large Canadian financial institution with a high investment grade rating.

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

c) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company manages its liquidity risk through management of its capital structure and financial leverage. Accounts payable and accrued liabilities are due within the current operating period.

d) Interest rate risk

The Company's exposure to interest rate risk results from the affects that changes in interest rates may have on the reported value of cash and cash equivalents. There is minimal risk that the Company would recognize any loss as a result of a decrease in the fair value of any short-term investments included in cash due to the short term nature. Based on the balance of cash and cash equivalents as at December 31, 2010, and assuming that all other variables remain constant, a 0.25% change in the US prime rate would result in an increase/decrease of $77,000 in the interest accrued by the Company per annum.

e) Equity market risk

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

16. COMMITMENTS

a) In conjunction with the development of the AK6 diamond mine, the Company has committed to approximately US$40 million in additional capital expenditures.

b) The Company and Boteti have entered into an exclusivity agreement whereby a lender has agreed to arrange funding for the development of the Boteti AK6 diamond mine ("Arranging Agreement"). Boteti is committed to paying a fee of US$750,000 if the arrangement is not drawn upon or if the Arranging Agreement is terminated by Boteti prior to June 30, 2011. In addition, a further US$750,000 is payable if an alternative lender provides funding within one year of terminating the Arranging Agreement.

17. CONTINGENCIES

a) In April 2010, legal proceedings were initiated against African Diamonds by two former directors of African Diamonds, alleging entitlement to a 3% royalty on production from the AK6 diamond project. Based on legal advice received, the Company and African Diamonds believe the claim is without merit and will continue to vigorously defend the claim. No provision has been made in the financial statements in relation to this claim.

b) Subsequent to year end, the Company terminated an agreement with a contractor at the Mothae project. The contractor has filed a claim against Mothae Diamonds and is alleging entitlement to an amount of approximately US$625,000. The Company has offered a settlement amount of US$90,000. A court date has been set for May 3, 2011 and the Company will continue to vigorously defend the claim.

18. SUBSEQUENT EVENTS

In February 2011, the Company completed a private placement of 60,000,000 common shares at a price of CAD$1.00 per share for gross proceeds of CAD$60 million. A finder's fee of 4% was paid on a portion of the gross proceeds.