Lucara Diamond Corp.

MD & A and Consolidated Financial Statements

Year Ending:
December 31, 2012

LUCARA DIAMOND CORP.
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2012

Management's discussion and analysis ("MD&A") focuses on significant factors that have affected Lucara Diamond Corp. (the "Company") and its subsidiaries performance and such factors that may affect its future performance. In order to better understand the MD&A, it should be read in conjunction with the audited consolidated financial statements of the Company for the year ended December 31, 2012, which are prepared in accordance with International Financial Reporting Standards. All amounts are expressed in U.S. dollars unless otherwise indicated. The effective date of this MD&A is March 21, 2013.

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.

SUMMARY FINANCIAL RESULTS FOR THE QUARTER AND FULL YEAR 2012 (1):

In millions of U.S. dollars unless otherwise noted	Three months ended December 31 **2012**	2011	Year ended December 31 **2012**	2011
Revenues	$ 29.1	$ -	$ 41.8	$ -
Cash operating earnings	17.7	-	23.6	-
EBITDA	12.9	(1.7)	(0.2)	(12.5)
Basic earnings (loss) per share	0.02	(0.01)	(0.02)	(0.05)
Cash flow from operations (before working capital adjustments)	15.1	(1.0)	3.8	(11.7)
Cash on hand	13.3	48.6	13.3	48.6

During 2012 the Company commenced production and declared commercial production at Karowe as at July 1, 2012. As a result, diamonds produced and sold post July 1, 2012 are recognized as revenue in the Company's consolidated statements of operations. The Company excluded Karowe's June, July and a portion of the September sales totalling 63,038 carats for proceeds of $12.8 million and related operating expenses and royalty expenses. These sales have not been included in the consolidated statement of operations and therefore gross margin and EBITDA for the year. The gross margin from these sales has been credited against capitalized plant and equipment. As a result, full year 2012 sales of $41.8 million are reported in the Company's accounts with total proceeds of $54.6 million being received.

Karowe Mine - Botswana (formerly AK6 Diamond Project)

- During 2012 the Company completed five sales totalling 215,762 carats for proceeds of $54.6 million during the year resulting in an average sales price of $253 per carat. Included in these results is the sale of a 9.46 carat blue diamond for $4.5 million or $477,272 per carat. A table reconciling sales proceeds and revenues reported in the Company's statement of operations can be found on page 7. Total sales forecast for 2013 is 400,000 carats.

- A total of 303,000 carats of diamond were recovered in 2012 against a forecast of 271,000 carats. Average grade processed during the fourth quarter of 2012 was 25.4 carats per hundred tonnes. The average grade processed for the year was 22.0 carats per hundred tonnes compared to a budget of 20.2 carats per hundred tonnes.

- Operating expenses per carat sold from the September, November and December sale was $92 per carat compared to a budget of $123 per carat.

- Cash operating earnings reported from the September, November and December sale (excluding depreciation, amortization and depletion) was $23.6 million or 56% of gross revenue.

Mothae Project - Lesotho

- In September, Mothae sold 4,657 carats produced during the test mining phase for proceeds of $1.5 million or an average price of $324 per carat.

- A final sale of Mothae diamonds recovered from the test mining phase was held in February 2013. A total of 2,102 carats of diamond were sold for $918,828 for an average price of $437 per carat representing all unsold diamonds recovered from the Mothae test mining phase.

- The Company is currently reviewing a number of development options for Mothae following the completion of its trial mining program.

Corporate

- Cash on hand as at December 31,2013 was $13.3 million. This included $4.5 million drawn from the Company's Scotiabank credit facility.

OPERATIONAL RESULTS:

Karowe Mine - Botswana (formerly AK6 Diamond Project)

- There were no Lost Time Injuries ("LTI's") or reportable environmental incidents at Karowe during the year continuing its excellent safety, health and environment record. There have been over 2.9 million hours worked without any LTI's since March 2011, including 1.8 million hours since the beginning of 2012. Karowe's Lost Time Injuries Frequency Rate ("LTIFR") was zero for 2012. LTIFR is defined as the total number of work hours lost per 200,000 work hours.

- Commissioning and production ramp-up activities to achieve sustainable production were completed in the third quarter. Ramp-up to full production capacity, which commenced in April, was achieved by August.

- During the fourth quarter, the mine treated 545,354 tonnes compared to a forecast of 538,242 tonnes, producing 138,487 carats against a forecast of 108,981 carats. During 2012, the mine treated 1.4 million tonnes, 9% above the forecast of 1.27 million tonnes, producing 303,000 carats, which was 12% above the forecast of 271,000 carats. The average recovered grade during the fourth quarter was 25.4 carats per hundred tonnes. The average recovered grade for 2012 was 22.0 carats per hundred tonnes.

Mothae Diamond Project - Lesotho

- The trial mining program was completed in September with final processing of hard, unweathered kimberlite from the central resource domain of the south lobe of the Mothae kimberlite. This brings the total tonnage sampled from the Mothae kimberlite for economic evaluation purposes to 603,819 dry tonnes yielding an average sample grade of 3.88 carats per hundred tonnes ("cpht").

- In the fourth quarter of 2012, the x-ray recovery tailings audit of all recovery tailings was completed. The project is now fully transitioned to a small care and maintenance team.

- The Company is currently reviewing a number of development options for Mothae following the completion of its trial mining program.

INTRODUCTION

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

The principal assets of the Company and the focus of the Company's development, exploration activities are its interests in assets in Lesotho and Botswana.

The following summarizes the Company's current land holdings:

Country	Project Name and Interest Held	Area (km^2)
Botswana	Karowe Diamond License (100% interest)	15.3
Lesotho	Mothae Diamond Mining Lease (75% interest)	20.0

Karowe Mine, Botswana (formerly AK6 Diamond Project)

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

In July 2010, a formal decision was made to proceed with the construction of the AK6 diamond mine. The project has been completed within budget at a cost marginally below $120 million. In January 2012 the name of the mine was officially changed to the Karowe Mine.

Based on the technical report for the Karowe Mine dated December 31, 2010, the project has an Indicated Resource of 51 million tonnes ("mt") containing an estimated 8.2 million carats ("ct") of diamond. The mine design delineates a Probable Reserve of 36.2 million tonnes of ore, containing an estimated 6.1 million carats of diamond at a 1.5mm bottom cut-off size, in an open pit to a depth of 324 meters. The reserves will be mined over an estimated 15 year life. The process plant has been designed at throughput rate of 2.5 million tonnes per annum ("mtpa").

Performance during the year ended December 31, 2012

In August, Karowe production exceeded design capacity near month end. Ramp-up to full process plant throughput, therefore, was achieved in a little over four months having overcome water supply and water demand issues. The equipping of additional boreholes added to the water supply, and this was effectively supplemented by return water from the slimes dam. These projects, along with reduced water consumption per tonne treated, as the operations team optimized the autogenous mill operation, enabled the mine to meet and then exceed design capacity within the third quarter.

The mill treated 1.4 million tonnes (9% above forecast) in 2012 and produced a total of 303,000 carats of diamond (12% above forecast). Average grade processed during the fourth quarter of 2012 was 25.4 carats per hundred tonnes. The average grade processed during 2012 was 22.0 per hundred tonnes.

During the year, the Company successfully conducted five diamond sales earning proceeds of $54.6 million. A table reconciling sales proceeds and revenues reported in the Company's statement of operations can be found on page 7. The Company withheld diamonds from the July sale as the rough diamond market softened, especially in the high-color, high-quality diamond categories. This was due to the diamonds not being offered a competitive price for the quality of goods on sale. These diamonds were then sold in September for an improved price. The sales in June and July were conducted with client viewings being held in Gaborone. For the last three sales in 2012, viewings were held in both Gaborone and Antwerp increasing the client base substantially. In the December sale the Company withheld diamonds in the small size categories due to low bidding volume. These were sold in the first sale of 2013.

The Karowe Mine was officially opened by the President of Botswana, His Excellency Lieutenant General Seretse Khama Ian Khama on August 17, 2012 by which time the process facilities had ramped up to design capacity and the Company had successfully conducted two diamond sales.

Mothae Diamond Project, Lesotho

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

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

Between February 2008 and December 2009, the Company conducted an 82,000 dry tonne bulk sample program to make an initial assessment of the nature of the diamond population contained within the Mothae kimberlite, to evaluate the grade potential of the pipe and to make a preliminary assessment of tonnage potential.

In 2010, the Company commenced a trial mining program to mine and process up to an additional 620,000 dry tonnes of material from various kimberlite domains, which had been identified in the bulk sample program. This trial mining was aimed at providing confirmation of the frequency of occurrence of high value diamonds within the principal kimberlite domains of the Mothae pipe, better assess the grade potential of these domains, delineate the tonnage potential and internal geology of the pipe to a depth of 300 meters. To establish the market value of Mothae diamonds, three sealed tender sales were held in March 2011, December 2011 and September 2012.

Performance during the year ended December 31, 2012

Trial mining on the Mothae project was completed in the fourth quarter of 2012.

The following table summarizes all kimberlite material processed from the Mothae pipe through to completion of the trial mining program:

Fiscal Period	**Wet Tonnage**	**Dry Tonnage**	**Stones**	**Carats***	**Ave Stn Size (ct/stone)**	**Dry Grade (cpht)***
Pre 2010	99,959	82,328	8,894	3,873.21	0.44	4.68
FY 2010	160,686	137,578	8,753	3,659.58	0.42	2.66
FY 2011	240,652	206,998	20,368	9,521.59	0.47	4.60
FY 2012	194,641	176,915	14,002	6,391.44	0.46	3.61
TOTALS	**695,938**	**603,819**	**52,017**	**23,445.82**	**0.45**	**3.88**

*All diamond recoveries and grades are reported at a bottom cut-off size of 2.0mm

Tonnage estimates are based on daily plant weightometer readings and moisture content measurements to determine a dry tonnage estimate. The process plant was operated at a 2.0mm bottom cut-off size for diamond recovery. Diamond recovery and characterization work was carried out by Mothae Diamonds sorting staff with recovery results being monitored and reported by Remote Exploration Services, also under contract to Mothae Diamonds.

The Company completed a diamond sale on September 2012. A total of 4,657 carats of diamond were sold for gross proceeds of $1.5 million for an average price of $324 per carat. The sale which took place in Antwerp consisted of 32 lots of which 26 were sold on a sealed tender basis.

Subsequent to year-end, the Company completed a diamond sale in February 2013. Approximately 2,100 carats of diamond were sold for gross proceeds of $900,000 for an average price of $437 per carat.

Work on the PEA of the Mothae kimberlite during the year included:

- development of a provisional resource model for the Mothae kimberlite. The model is currently subject to review by an independent Qualified Person (as defined by NI43-101) who will prepare an Independent Technical Report on the Motahe resource. This report will be filed on SEDAR in the second quarter of 2013.

- development of a provisional mine design and mine plan.
- finalization of conceptual layouts for site infrastructure, and
- preliminary estimation of costs for various design options and infrastructure development.

The Company is currently reviewing a number of development options for Mothae following the completion of its trial mining program.

SELECT ANNUAL FINANCIAL INFORMATION

In millions of U.S. dollars unless otherwise noted	**2012**	**Year ended December 31, 2011**	**2010**
Revenues	$ 41.8	$ -	$ -
Operating expenses	(14.0)	-	-
Royalty expenses	(4.2)	-	-
Cash operating earnings (1)	**23.6**	-	-
Exploration expenditures	(12.8)	(6.6)	(11.6)
Administration	(9.5)	(8.2)	(4.4)
Gain on sale of diamonds	-	2.3	-
Sales and marketing	(1.5)	-	-
EBITDA (2)	**(0.2)**	(12.5)	(16.0)
Depletion, amortization and accretion	(5.9)	-	-
Finance income (expenses)	(3.1)	(1.9)	0.4
Foreign exchange gain (loss)	1.7	(4.3)	-
Net loss for the year	**(7.5)**	(18.7)	(15.6)
Total equity	**157.5**	170.4	137.5
Cash flow from operations (before working capital adjustments)	**3.8**	(11.7)	(13.3)
Total assets	**235.4**	241.3	145.5
Cash on hand	**13.3**	48.6	32.9
Loss per share (basic and diluted)	**(0.02)**	(0.05)	(0.06)
Per carat sold			
Sales price	**$ 274**	$ -	-
Operating expenses	**92**	-	-
Average grade (carats per hundred tonnes)	**22.0**	-	-

(1) Cash operating earnings is a non-GAAP measure defined as sales less operating expenses and royalty expenses.
(2) EBITDA is a non-GAAP measure defined as earnings before interest, taxation, depreciation and amortization.

Reconciliation of Revenues:

Karowe sales during the year	**Carats**	**Proceeds (US$ million)**	**US$ per carat**
Q2 2012	26,196	5.6	$ 214
Q3 2012	88,579	19.9	225
Q4 2012	100,987	29.1	288(3)
	215,762	**54.6**	**253**
Diamonds produced pre-commercial production and sold during the year			
Q2 2012	26,196	5.6	214
Q3 2012	36,842	7.2	195
Q4 2012	-	-	-
	63,038	**12.8**	**203**
Revenues reported	**152,724**	**41.8**	**274**

(3) Proceeds in the fourth quarter of 2012 included the sale of a 9.46 carat blue diamond for $4.5 million or $477,272 per carat.

RESULTS OF OPERATIONS

Commissioning and testing at Karowe were completed during June 2012 and as a result the Company determined that the mine was ready for its intended use and as such commercial production was declared on July 1, 2012. As a result, diamonds produced prior to July 1, 2012 are credited against the capitalized costs of construction as they are sold, including those sold after July 1, 2012. Diamonds produced from July 1, 2012 are recognized in the consolidated statement of operations upon sale. The July sale and 489 carats of diamond sold as part of the September sale included diamonds produced prior to July 1, 2012 and therefore these proceeds were credited against the capitalized costs in plant and equipment and are not included in the consolidated statement of operations.

Revenues

During the year the Company had five sales totalling 215,762 carats for gross proceeds of $54.6 million at an average price of $253 per carat. The Company's revenues for the year do not include the June and July sale or 489 carats of diamond sold in the September sale as these diamonds were produced pre-commercial production and under IFRS are reported as part of plant and equipment. Therefore gross revenues for the year of $41.8 million include 51,737 carats from the September sale and 100,987 carats from the November and December sale. Included in these results is the sale of a 9.46 carat blue diamond for $4.5 million or $477,272 per carat.

Cash operating earnings

Cash operating earnings for the year was $23.6 million. This reflects a $274 per carat price received for diamonds sold in September through December net of royalties of 10% and operating expenses of $92 per carat sold.

Cash operating earnings of $23.6 million result in a gross margin of 56% on sales. The average grade for the year was 22.0 carats per hundred tonnes.

Cash operating earnings is a non-GAAP measure and is reconciled in the table above.

Exploration expenditures

The exploration expenditures relate primarily to the on-going trial mining program, which commenced in May 2010 at Mothae, offset in part by the value of diamonds recovered and sold, based on management's best estimate of the value of the diamonds at the time of recovery. The difference between the carrying value and the subsequent proceeds from the sale of diamonds is treated as a gain or loss as it is a change in market conditions during the period.

Exploration expenditures were $12.9 million during the year compared to $6.6 million in 2011. The difference largely relates to decreased diamond recoveries during the year as harder material was processed at a slower rate, costs relating to work on Mothae's preliminary economic assessment and further costs for non-recurring care and maintenance activities.

The expenditures in 2012 have been partially mitigated by the earnings from Mothae's sale of 4,657 carats in September yielding gross proceeds of $1.5 million.

Administration expenses

The increase in administration expenses for the year ended December 31, 2012 compared to the prior year is largely due to the payment of performance incentive bonuses to key employees of the Company and other non-recurring costs.

Earnings before interest, tax, depreciation and amortization (EBITDA)

EBITDA for the year was a loss of $0.2 million. EBITDA was impacted by:

- Exclusion of Karowe's June, July and a portion of the September sale totalling 63,038 carats for proceeds of $12.8 million and related operating expenses and royalty expenses. These sales have not been included in the consolidated statement of operations and therefore gross margin and EBITDA for the year. The gross margin from these sales has been credited against capitalized plant and equipment. As a result, full year 2012 sales of $41.8 million are reported in the Company's accounts with total proceeds of $54.6 million being received.

- Exploration expenditures of $12.9 million at Mothae were due to its trial mining program and costs incurred for its preliminary economic assessment. Mothae has now been placed on temporary care and maintenance with limited operating expenditure going forward pending a decision regarding potential development options for the project.

- Higher administration costs during the period due to some non-recurring costs.

SUMMARY OF QUARTERLY RESULTS

Three months ended	Dec-12	Sept-12	Jun-12	Mar-12
A. Total revenues	29,171,742	12,658,547	Nil	Nil
B. Exploration expenditures	(2,277,062)	(4,464,791)	(2,798,489)	(3,313,504)
C. Administration expenses	(1,798,381)	(2,979,850)	(3,392,079)	(1,363,964)
D. Net income (loss)	7,664,989	(3,413,079)	(7,607,000)	(4,169,711)
E. Earnings (loss) per share (basic and diluted)	0.02	(0.01)	(0.02)	(0.01)

Three months ended	Dec-11	Sept-11	Jun-11	Mar-11
A. Total revenues	Nil	Nil	Nil	Nil
B. Exploration recovery (expenditures)	564,851	(3,116,383)	(2,866,454)	(1,200,247)
C. Administration expenses	(2,254,982)	(1,304,914)	(1,845,748)	(2,776,978)
D. Net income (loss)	(5,438,374)	(5,453,107)	(5,921,521)	(1,860,890)
E. Earnings (loss) per share (basic and diluted)	(0.01)	(0.01)	(0.02)	(0.01)

Operating expenses and net income (loss), quarter over quarter, vary in relation to the level of activities undertaken by the Company during the financial quarters reported. These activities include the volumes and timing of diamond sales, the net price realized in such sales, cost of goods sold, corporate development initiatives and net exploration expenditures incurred.

Revenues

During the fourth quarter of 2012 the Company had two diamond sales totalling 100,987 carats for gross proceeds of $29.1 million at an average price of $289 per carat. Included in these results is the sale of a 9.46 carat blue diamond for $4.5 million or $477,272 per carat.

Exploration expenditures

Exploration expenditures in the fourth quarter of 2012 primarily relate to work on Mothae's preliminary economic assessment. During the fourth quarter of 2011, Mothae held a diamond sale, which had offset the majority of exploration expenditures incurred in the same quarter.

Administration expenses

The decrease in administration expenses for the three months ended December 31, 2012 compared to the same quarter in 2011 is due primarily to a reduction in corporate activities during the fourth quarter of 2012.

Net income

Net income for the three months ended December 31, 2012 was $7.7 million reflecting the recognition of revenues and related costs from the Karowe Mine.

LIQUIDITY AND CAPITAL RESOURCES

As at December 31, 2012, the Company had cash and cash equivalents of $13.3 million compared to cash and cash equivalents of $48.6 million at December 31, 2011.

Cash generated from operating activities before working capital movements for the year ended December 31, 2012 was an inflow of $3.8 million. This includes Karowe sales from September to December with cash operating earnings of $23.6 million as well as Mothae's September sale for proceeds of $1.5 million. These proceeds were offset by Mothae's exploration costs to complete its trial mining program and work on the preliminary economic assessment as well as corporate costs. The June, July and a portion of the September sale with proceeds of $12.8 million have been included as part of investing activities and not operating cash flows as these sales included pre-commercial production and was reported net of costs in capitalized plant and equipment.

In April the Company signed a definitive agreement with the Bank of Nova Scotia for a $25 million revolving term credit facility with a maturity date of March 26, 2014, which may be extended if both parties agree.

The facility contains financial and non-financial covenants customary for a facility of this size and nature. As at December 31, 2012, the Company is in compliance with all financial and non-financial covenants. The applicable interest rate of any loan under the facility will be determined by the Company's leverage ratio at any given time. The Company has provided security on the two year facility by way of a charge over the Company's Karowe assets and a guarantee by the Company's subsidiaries, which hold the Karowe assets. As at December 31, 2012 the Company had drawn $4.5 million of the credit facility.

Net cash from financing activities for the year ended December 31, 2012 included a $9.5 million drawdown and a $5 million repayment on the Scotiabank credit facility.

The Company has entered into foreign currency contracts totalling $8.0 million as at December 31, 2012 to help manage the uncertainty of foreign exchange fluctuations in the market. The contracts mature in March 2013 and May 2013. They are at an average rate of Botswana Pula 7.8244 per $1.00. Subsequent to December 31, 2012, the Company entered into a series of forward exchange contracts to fix the rate at which future anticipated cash flows in U.S. dollars are exchanged in Botswana Pula. Such contracts include forward sales of U.S. dollars at an average rate of 7.9581, in the aggregate amount of $43.3

million from February 2013 to December 2013. As a result, the Company's outstanding forward exchange contracts totalled $51.4 million at an average rate of 7.9369.

FUTURE PLANS AND OUTLOOK

Boteti Karowe Mine, Botswana

Karowe's 2013 budget is to mine and process 2.5 million tonnes of ore and to produce 400,000 carats of diamond for sale.

The Company anticipates holding eight sales (two per quarter) in 2013. The sales are anticipated to average 50,000 carats of diamond each and there will be client viewings conducted in both Gaborone and Antwerp.

Mothae Diamond Project, Lesotho

The Mothae project will remain on care and maintenance pending a decision regarding potential development options for the project.

NON-GAAP FINANCIAL MEASURES

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

Cash operating earnings (see "Select Annual Financial Information") is the term the Company uses to describe the cash that is generated from sales net of cost of goods sold, excluding depletion, amortization and accretion, and excluding the effect of changes in working capital.

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

NEW IFRS PRONOUNCEMENTS AND AMENDMENTS TO OTHER STANDARDS

Unless otherwise noted, the following revised standards and amendments are effective for annual periods beginning on or after January 1, 2013 with earlier application permitted.

a) IFRS 9 *Financial Instruments* was issued by the IASB as the first step step in its project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on an entity's business model and the contractual cash flows of the financial asset. Classification is made at the time the financial asset is initially recognized, namely when the entity becomes a party to the contractual provisions of the instrument. IFRS 9 amends some of the requirements of IFRS 7 Financial Instruments: Disclosures, including added disclosures about investments in equity instruments measured at fair value in OCI, and guidance on the measurement of financial liabilities and derecognition of financial instruments. In December 2011, the IASB issued an amendment that adjusted the mandatory effective date of IFRS 9 from January 1, 2013 to January 1, 2015. The Company is currently assessing the impact of adopting IFRS 9 on the consolidated financial statements, including the applicability of early adoption.

b) IFRS 10 *Consolidated Financial Statements* requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 *Consolidation – Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statements*. The Company will apply IFRS 10 beginning on January 1, 2013. The Company has completed an analysis of IFRS 10 and do not expect any significant effect on the consolidated financial statements as a result of adopting this standard.

c) IFRS 11 *Joint Arrangements* requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Nonmonetary Contributions by Venturers*. The Company will apply IFRS 11 beginning on January 1, 2013. The Company has completed an analysis of IFRS 11 and do not expect any significant effect on the consolidated financial statements as a result of adopting this standard.

d) IFRS 12 *Disclosure of Interests in Other Entities* establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosure that address the nature of, and risks associated with, an entity's interests in other entities. The Company will apply IFRS 12 beginning on January 1, 2013. The Company has completed an analysis of IFRS 12 and do not expect any significant effect on the consolidated financial statements as a result of adopting this standard.

e) IFRS 13 *Fair Value Measurement* is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures. The Company will apply IFRS 13 beginning on January 1, 2013. The Company has completed an analysis of IFRS 13 and do not expect any significant effect on the consolidated financial statements as a result of adopting this standard.

f) IAS 1 *Presentation of Financial Statements* has been amended to require companies to group together items within Other Comprehensive Income ('OCI') that may be reclassified to the profit and loss section of the income statement. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. The amendments to this standard do not change the nature of the items that are currently recognized in OCI. The Company will present these changes in the consolidated statement of comprehensive loss in the consolidated financial statements in the first quarter of 2013.

g) IFRS 7 *Financial Instruments: Disclosures* has been amended to include additional disclosure requirements in the reporting of transfer transactions and risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitization of financial assets. The Company will apply IFRS 7 beginning on January 1, 2013. The Company has completed an analysis of IFRS 7 and do not expect any significant effect on the consolidated financial statements as a result of adopting this standard.

h) IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine was issued by the IASB in October 2011 and provides guidance on the accounting for the costs of stripping activity in the production phase of surface mining when two benefits accrue to the entity from the stripping activity: useable ore that can be used to produce inventory and improved access to further quantities of material that will be mined in future periods. IFRIC 20 will be applied starting January 1, 2013. The Company will amend its accounting policy on production phase stripping costs to require the Karowe Mine to consider components of the pit in the assessment of whether or not a future benefit has been created by the mining activities in the period. The Company expects that this will lead to an increase in the amount of stripping costs that are capitalized over the life of the open pit mine. The Company is in the process of calculating the effect of IFRIC 20 on the comparative consolidated financial statements for all periods of 2012.

CRITICAL ACCOUNTING ESTIMATES

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

Note 3 to the audited consolidated financial statements for the year ended December 31, 2012 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.

Commercial production – Operating levels intended by the Company

Prior to reaching operating levels intended by the Company, costs incurred are capitalized as part of plant and equipment and proceeds from sales are offset against costs capitalized. Recognition of sales and depletion of capitalized costs in the statement of operations begin when the asset is ready for its intended use. The results of operations of the Company during the year have been impacted by the Company's determination that the Karowe Mine was ready for its intended use on July 1, 2012.

Depreciation, depletion and accretion

Mineral properties and plant and equipment comprise a large component of the Company's assets and as such, depreciation and depletion of these assets have a significant effect on the Company's financial statements. Upon commencement of commercial production, the Company amortizes mineral property and mining equipment and other assets over the life of the mine based on the depletion of the mine's proven and probable reserves. In the case of mining equipment and other assets, if the useful life of the asset is shorter than the life of the mine, the asset is amortized over its expected useful life.

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

A change in the original estimate of reserves would result in a change in the rate of depreciation and amortization of the related mining assets and could result in an impairment of the mining assets.

Mineral properties

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

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

Income taxes

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

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

Stock-based compensation

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

RELATED PARTY TRANSACTIONS

During the year ended December 31, 2012, the Company incurred the following expenses with Namdo Management Services Limited ("Namdo"), Mile High Holdings Ltd. ("Mile High") and Lundin Foundation ("LF"), companies related by way of directors in common. The Company also incurred professional geological services and laboratory related expenditures from the Mineral Services Group ("MS Group"), a company that is associated with a director of Company.

Description of services	Related party	2012	2011
Management fees	Namdo	$ 504,202	$ 505,850
Donations	LF	-	607,020
Exploration related expenditures	MS Group	1,915,835	125,598
Aircraft charter	Mile High	381,897	-
		$ 2,801,934	$ 1,238,468

OUTSTANDING SHARE DATA

As at the date of this MD&A, the Company had 376,292,749 common shares outstanding and 2,465,000 stock options outstanding under its stock-based incentive plan. As at the same date, the Company had no stock purchase warrants outstanding.

FINANCIAL INSTRUMENTS

Financial assets and liabilities have been classified into categories that determine their basis of measurement and, for items measured at fair value, whether changes in fair value are recognized in the consolidated statements of operations or consolidated statements of comprehensive loss. Those categories are: fair value through profit or loss; loans and receivables; available for sale assets; and, for liabilities, amortized cost.

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

In the normal course of business, the Company is inherently exposed to currency and commodity price risk. The Company uses currency hedging instruments to mitigate the currency price risk. For a discussion of certain risks and assumptions that relate to the use of derivatives, including equity market risk, liquidity risk and credit risk, refer to Note 21 in the Company's consolidated financial statements. For a discussion of the methods used to value financial instruments, as well as any significant assumptions, refer also to Note 21 of the Company's consolidated financial statements.

CONTINGENCIES

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

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

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

RISKS AND UNCERTAINTIES

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

Liquidity

The Company's consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due.

In July 2011, the Company secured a $50 million debenture (the "debenture") to fund the development of the Company's projects. The debenture has been issued by Zebra Holdings and Investments S.a.r.l ("Zebra") and Lorito Holdings S.a.r.l ("Lorito"), each an investment company owned by a trust settled by the late Adolf H. Lundin, and not a related party of the Company. Zebra and Lorito hold a total of 60,000,000 common shares of the Company, which represent approximately 16.1% of the current outstanding common shares.

In July 2012, the Company renegotiated the terms of the debenture resulting in quarterly repayments of $8.3 million commencing March 31, 2013 and a final maturity date of June 30, 2014. No interest is payable during the term of the facility. The Company's ability to repay the quarterly instalment payments on its debenture depends on a number of factors, some of which are beyond the Company's control, including the global economy and the demand for and selling price of our diamonds.

The Company will pay the first quarterly instalment payment due March 31, 2013. However, market weakness may impact the company's ability to make its quarterly debenture payments. Although the Company has a $25 million revolving credit facility, under the terms of this facility, it cannot be used to repay the debenture.

The Company will continue to monitor and forecast its expected cash flow from operations. However, should factors beyond the Company's control worsen, the Company will begin discussions with Zebra and Lorito to negotiate amendments to the debenture to provide the Company with additional time to generate cash and/or access appropriate sources of long-term financing to repay the debenture. Although the Company has been successful in renegotiating the debenture in the past, there can be no assurance that the Company will be successful again.

Economic conditions

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

Uncertainties related to mineral resource estimates

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

Diamond prices and marketability

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

Licenses, permits and approvals

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

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

Currency risk

Currency fluctuations may impact the Company's financial performance. Diamonds are sold in US dollar with a majority of the Company's costs and expenses being incurred in Botswana Pula, Lesotho Maloti, South African Rand, Canadian dollar and U.S. dollar currencies. As a consequence, fluctuations in exchange rates may have a significant effect on the cash flows and operating results of the Company in either a positive or negative direction. In order to mitigate foreign exchange fluctuations the Company has hedged a proportion of its Botswana pula costs for the 2013 financial year.

Mining and processing

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

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

Environmental and other regulatory requirements

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

Foreign operations risk

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

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

Mineral exploration and development

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

Title matters

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

Infrastructure

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

Uninsured risks

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

Competition

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

Current and future legal proceedings

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

Conflicts of interest

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

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

Key personnel

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

Share price volatility

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

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements.

FINANCIAL INFORMATION

The report for the three months ended March 31, 2013 is expected to be published on May 9, 2013.

INTERNAL FINANCIAL REPORTING AND DISCLOSURE CONTROLS

The Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") are responsible for the design and effectiveness of internal controls over financial reporting (as such term is defined in National Instrument 52-109 – *Certification of Disclosure in Issuers' Annual and Interim Filings* ("NI 52-109")), to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements in accordance with accounting principles generally accepted in Canada. The Company maintains an effective control environment and has used the *Internal Control -- Integrated Framework* (COSO Framework) published by The Committee of Sponsoring Organizations of the Treadway Commission to design the Company's internal controls over financial reporting. The Company's CEO and CFO believe that the Company's internal controls and procedures are effective in providing reasonable assurance that financial information is recorded, processed, summarized and reported in a timely manner.

The Company's CEO and CFO are also responsible for the design and effectiveness of disclosure controls and procedures (as such term is defined in NI 52-109) to provide reasonable assurance that material information related to the Company, including its consolidated subsidiaries, is made known to the Company's certifying officers. The Company's CEO and CFO believe that the Company's disclosure controls and procedures are effective in providing reasonable assurance that information required to be disclosed under applicable securities legislation is recorded, processed, summarized and reported in a timely manner.

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

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

Forward looking statements are based on the opinions and estimates of management as of the date such statements are made, and they are subject to a number of known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievement expressed or implied by such forward-looking statements. The Company believes that expectations reflected in this forward-looking information are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking information included in this MD&A should not be unduly relied upon. In particular, this MD&A may contain forward looking information pertaining to the following: the estimates of the Company's mineral reserve and resources; estimates of the Company's production and sales volumes for the Karowe Mine; estimated costs to construct the Karowe Mine, start-up, exploration and development plans and objectives, production costs, exploration and development expenditures and reclamation costs; expectation of diamond price and changes to foreign currency exchange rate; expectations regarding the need to raise capital; possible impacts of disputes or litigation and other risks and uncertainties describe under Risks and Uncertainties disclosed in the Company's Annual Information Form.

There can be no assurance that such statements will prove to be accurate, as the Company's results and future events could differ materially from those anticipated in this forward-looking information as a result of those factors discussed in or referred to under the heading "Risk Factors' in the Company's Annual Information Form dated March 22, 2012 available at http://www.sedar.com, as well as changes in general business and economic conditions, changes in interest and foreign currency rates, the supply and demand for, deliveries of and the level and volatility of prices of rough diamonds, costs of power and diesel, acts of foreign governments and the outcome of legal proceedings, inaccurate geological and recoverability assumptions (including with respect to the size, grade and recoverability of mineral reserves and resources), unanticipated operational difficulties (including failure of plant, equipment or processes to operate in accordance with specifications or expectations, cost escalations, unavailability of materials and equipment, government action or delays in the receipt of government approvals, industrial disturbances or other job actions, adverse weather conditions, and unanticipated events relating to health safety and environmental matters)

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

March 21, 2013

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, 2012 and December 31, 2011 and the consolidated statements of operations, comprehensive loss, cash flows and changes in equity for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the 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, 2012 and December 31, 2011 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

signed "PricewaterhouseCoopers LLP"

Chartered Accountants

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

	December 31, 2012	December 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents (Note 21)	$ 13,261,484	$ 48,589,409
Investments (Note 21)	85,517	109,020
Trade receivables and other (Note 5)	5,526,880	6,298,262
Inventories (Note 6)	13,300,257	1,597,255
	32,174,138	56,593,946
Plant and equipment (Note 7)	118,395,399	94,501,245
Mineral properties (Note 8)	84,645,249	90,042,677
Other non-current assets	136,754	149,513
TOTAL ASSETS	$ 235,351,540	$ 241,287,381
LIABILITIES		
Current liabilities		
Trade payables and accrued liabilities (Note 21)	$ 14,694,757	$ 16,635,832
Current portion of long-term debt (Note 9)	30,310,587	10,950,493
	45,005,344	27,586,325
Long-term debt (Note 9)	20,643,420	30,864,165
Restoration provisions (Note 10)	12,241,624	12,485,650
TOTAL LIABILITIES	77,890,388	70,936,140
EQUITY		
Share capital (Note 11)	282,796,453	278,995,472
Contributed surplus (Note 12)	4,874,086	5,769,245
Cumulative deficit	(110,739,778)	(104,243,885)
Accumulated other comprehensive loss	(21,381,019)	(13,200,175)
Total equity attributable to shareholders of the Company	155,549,742	167,320,657
Non-controlling interests (Note 13)	1,911,410	3,030,584
TOTAL EQUITY	157,461,152	170,351,241
TOTAL LIABILITIES AND EQUITY	$ 235,351,540	$ 241,287,381

Contingencies (Note 23) and subsequent events (Note 24)

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

Approved on Behalf of the Board of Directors:

"Paul K. Conibear"
Director

"William Lamb"
Director

LUCARA DIAMOND CORP.

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

	2012	2011
Revenues	$ 41,830,289	$ -
Cost of goods sold		
Operating expenses	13,991,620	-
Royalty expenses (Note 8)	4,183,029	-
Depletion, amortization and accretion	5,898,139	-
	24,072,788	-
Income from mining operations	17,757,501	-
Other expenses		
Exploration expenditures (Note 14)	12,853,846	6,618,233
Administration (Note 15)	9,534,274	8,182,622
Gain on sale of diamonds (Note 16)	-	(2,339,282)
Sales and marketing	1,481,446	-
Finance expenses	3,102,576	1,854,528
Foreign exchange loss (gain)	(1,689,840)	4,357,791
	25,282,302	18,673,892
Net loss for the year	$ (7,524,801)	$ (18,673,892)
Attributable to:		
Shareholders of the Company	$ (5,910,917)	$ (18,126,567)
Non-controlling interests	$ (1,613,884)	$ (547,325)
Basic and diluted loss per common share (Note 18)	$ (0.02)	$ (0.05)
Weighted average common shares outstanding (Note 18)	374,621,554	360,019,710

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

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

	2012	2011
Net loss for the year	$ (7,524,801)	$ (18,673,892)
Other comprehensive loss		
Change in fair value of available-for-sale securities	(25,951)	(181,725)
Currency translation adjustment	(8,245,159)	(18,438,911)
	(8,271,110)	(18,620,636)
Comprehensive loss	$ (15,795,911)	$ (37,294,528)
Comprehensive loss attributable to:		
Shareholders of the Company	(14,091,761)	(36,468,063)
Non-controlling interests	(1,704,150)	(826,465)
	$ (15,795,911)	$ (37,294,528)

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

LUCARA DIAMOND CORP.

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

	2012	2011
Cash flows from (used in):		
Operating Activities		
Net loss for the year	$ (7,524,801)	$ (18,673,892)
Items not involving cash and cash equivalents:		
Depletion, amortization and accretion	9,306,194	2,641,443
Foreign exchange loss (gain)	(1,037,453)	918,727
Stock-based compensation	285,843	609,705
Other	-	6,547
Finance costs	2,779,276	2,817,836
	3,809,059	(11,679,634)
Net changes in working capital items:		
Trade receivables and other current assets	705,731	(4,059,412)
Inventories	(10,122,634)	2,544,063
Trade payables and accrued liabilities	8,505,005	(388,931)
	2,897,161	(13,583,914)
Financing Activities		
Proceeds from issue of shares, net of issue costs	-	58,283,612
Proceeds from long-term debt	-	50,000,000
Proceeds from revolving credit facility	9,500,000	-
Repayments of revolving credit facility	(5,000,000)	-
Finance costs paid	(585,378)	(1,484,536)
Proceeds from exercise of stock options	2,619,979	575,900
	6,534,601	107,374,976
Investing Activities		
Acquisition of plant and equipment	(44,440,839)	(77,191,407)
Other	7,008	23,576
	(44,433,831)	(77,167,831)
Effect of exchange rate change on cash and cash equivalents	(325,856)	(918,727)
Increase (decrease) in cash and cash equivalents during the year	(35,327,925)	15,704,504
Cash and cash equivalents, beginning of year	48,589,409	32,884,905
Cash and cash equivalents, end of year	$ 13,261,484	$ 48,589,409
Supplemental Information		
Interest received	311,407	963,308
Taxes paid	-	-
Changes in accounts payable and accrued liabilities related to plant and equipment	(10,620,633)	11,409,099
Common shares issued for debenture (Note 11)	-	10,663,220

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

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

	Number of shares issued and outstanding	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive income (loss)	Non-controlling interests	Total
Balance, January 1, 2011	302,494,050	$ 209,210,999	$ 5,421,258	$ (84,121,453)	$ 5,141,321	$ 1,861,184	$ 137,513,309
Private placement, net of share issue costs	60,000,000	58,283,612	-	-	-	-	58,283,612
Shares issued in lieu of interest and fees (Note 8)	9,000,000	10,663,220	-	-	-	-	10,663,220
Exercise of stock options	854,999	837,641	(261,718)	-	-	-	575,923
Stock-based compensation	-	-	609,705	-	-	-	609,705
Effect of foreign currency translation	-	-	-	-	(18,159,771)	(279,140)	(18,438,911)
Unrealized loss on investments	-	-	-	-	(181,725)	-	(181,725)
Free-carried non-controlling interests (Note 13)	-	-	-	(1,995,865)	-	1,995,865	-
Net loss for the year	-	-	-	(18,126,567)	-	(547,325)	(18,673,892)
Balance, December 31, 2011	372,349,049	$ 278,995,472	$ 5,769,245	$ (104,243,885)	$ (13,200,175)	$ 3,030,584	$ 170,351,241
Balance, January 1, 2012	372,349,049	$ 278,995,472	$ 5,769,245	$ (104,243,885)	$ (13,200,175)	$ 3,030,584	$ 170,351,241
Exercise of stock options	3,943,700	3,800,981	(1,181,002)	-	-	-	2,619,979
Stock-based compensation	-	-	285,843	-	-	-	285,843
Effect of foreign currency translation	-	-	-	-	(8,154,893)	(90,266)	(8,245,159)
Unrealized loss on investments	-	-	-	-	(25,951)	-	(25,951)
Free-carried non-controlling interests (Note 13)	-	-	-	(584,976)	-	584,976	-
Net loss for the year	-	-	-	(5,910,917)	-	(1,613,884)	(7,524,801)
Balance, December 31, 2012	376,292,749	$ 282,796,453	$ 4,874,086	$ (110,739,778)	$ (21,381,019)	$ 1,911,410	$ 157,461,152

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

1. NATURE OF OPERATIONS

Lucara Diamond Corp. together with its subsidiaries (collectively referred to as the "Company") is a diamond mining company focused on the development and operation of diamond properties in Africa. The Company holds a 100% interest in the Karowe Mine (previously named AK6 Diamond Project) located in Botswana and a 75% interest in Mothae Diamond Project located in Lesotho.

The Company's common shares are listed on the TSX, NASDAQ OMX First North and Botswana Stock Exchanges. The Company was continued into the Province of British Columbia under the Business Corporations Act (British Columbia) in August 2004 and its registered office is located at Suite 2610 - 1066 West Hastings Street, Vancouver, British Columbia, V6C 3E8.

2. BASIS OF PRESENTATION

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

These financial statements were approved by the Board of Directors for issue on March 21, 2013.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

(a) Basis of measurement

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

(b) Consolidation

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Subsidiaries are entities controlled by the Company. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are included in the consolidated financial statements from the date control is obtained until the date control ceases. Where the Company's interest is less than 100%, the Company recognized non-controlling interests. All intercompany balances, transactions, income, expenses, profits and losses, including unrealized gains and losses have been eliminated on consolidation. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

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

(c) Critical accounting estimates and judgments

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

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

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

(d) Segment reporting

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

The Company's primary reporting segments are based on individual diamond properties, being the Karowe Mine and the Mothae Diamond Project and Corporate. The Corporate office provides support to the diamond properties with respect to treasury and finance, technical support, regulatory reporting and corporate administration.

(e) Foreign currency translation

Functional and presentation currency

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Transactions and balances

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

Group companies

The functional currency of the significant subsidiaries of the Company are Boteti Mining (PTY) Ltd., which has a Pula functional currency and Mothae Diamonds (Pty) Ltd, which has a Loti functional currency. The results and financial position of the group companies, which have a functional currency different from the presentation currency, are translated into the presentation currency as follows:

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

(f) Cash and cash equivalents

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

(g) Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

(i) Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated statement of operations. Gains and losses arising from changes in fair value are presented in the consolidated statement of operations within "other gains and losses" in the period in which they arise. Non-derivative financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the balance sheet date, which are classified as non-current.

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

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

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of financial assets

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

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

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

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

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

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

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

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

(h) Inventories

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Plant and equipment

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

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

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

Machinery	5 to 10 years
Plant facilities	based on resources on a unit of production basis
Furniture and office equipment	2 to 3 years

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

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

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

(j) Exploration and evaluation expenditures and mineral properties

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

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

Exploration and development expenditures are expensed as incurred on mineral properties not sufficiently advanced as to identify their development potential. When it has been established that a mineral property is considered to be sufficiently advanced and an economic analysis has been completed, all further expenditures for the current year and subsequent years are capitalized as incurred. Costs associated with acquiring a mineral property are capitalized as incurred.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Intangible assets

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

(l) Impairment of non-financial assets

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

(m) Provisions

Asset retirement obligations

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

Environmental expenditures

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Other provisions

Provisions are recognized when:

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

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

(n) Deferred income taxes

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

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

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

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

(o) Share capital

Common shares are classified as equity.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(p) Revenue recognition

Revenues from diamond sales are recognized when the risks and rewards of ownership pass to the customer and when collection is reasonably assured.

(q) Royalties

Royalties and revenue-based taxes are accounted for under IAS 12 when they have the characteristics of income tax. This is considered to be the case when they are imposed under Government authority and the amount payable is based on taxable income – rather than based on quantity produced or as a percentage of revenue. For such arrangements, current and deferred tax is provided on the same basis as described above for other forms of taxation. Obligations arising from royalty arrangements that do not satisfy these criteria are recognized as current provisions and disclosed as part of royalty expenses. The royalties incurred by the Company are considered not to meet the criteria to be treated as part of income tax.

(r) Stock-based compensation

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

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

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

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

(s) Loss per share

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

(t) Leases

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(u) Borrowing costs

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

4. ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET ADOPTED

Unless otherwise noted, the following revised standards and amendments are effective for annual periods beginning on or after January 1, 2013 with earlier application permitted.

a) IFRS 9 *Financial Instruments* was issued by the IASB as the first step step in its project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on an entity's business model and the contractual cash flows of the financial asset. Classification is made at the time the financial asset is initially recognized, namely when the entity becomes a party to the contractual provisions of the instrument. IFRS 9 amends some of the requirements of IFRS 7 Financial Instruments: Disclosures, including added disclosures about investments in equity instruments measured at fair value in OCI, and guidance on the measurement of financial liabilities and derecognition of financial instruments. In December 2011, the IASB issued an amendment that adjusted the mandatory effective date of IFRS 9 from January 1, 2013 to January 1, 2015. The Company is currently assessing the impact of adopting IFRS 9 on the consolidated financial statements, including the applicability of early adoption.

b) IFRS 10 *Consolidated Financial Statements* requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 *Consolidation – Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statements*. The Company will apply IFRS 10 beginning on January 1, 2013. The Company has completed an analysis of IFRS 10 and do not expect any significant effect on the consolidated financial statements as a result of adopting this standard.

c) IFRS 11 *Joint Arrangements* requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Nonmonetary Contributions by Venturers*. The Company will apply IFRS 11 beginning on January 1, 2013. The Company has completed an analysis of IFRS 11 and do not expect any significant effect on the consolidated financial statements as a result of adopting this standard.

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

d) IFRS 12 *Disclosure of Interests in Other Entities* establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosure that address the nature of, and risks associated with, an entity's interests in other entities. The Company will apply IFRS 12 beginning on January 1, 2013. The Company has completed an analysis of IFRS 12 and do not expect any significant effect on the consolidated financial statements as a result of adopting this standard.

e) IFRS 13 *Fair Value Measurement* is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures. The Company will apply IFRS 13 beginning on January 1, 2013. The Company has completed an analysis of IFRS 13 and do not expect any significant effect on the consolidated financial statements as a result of adopting this standard.

f) IAS 1 *Presentation of Financial Statements* has been amended to require companies to group together items within Other Comprehensive Income ('OCI') that may be reclassified to the profit and loss section of the income statement. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. The amendments to this standard do not change the nature of the items that are currently recognized in OCI. The Company will present these changes in the consolidated statement of comprehensive loss in the consolidated financial statements in the first quarter of 2013.

g) IFRS 7 *Financial Instruments: Disclosures* has been amended to include additional disclosure requirements in the reporting of transfer transactions and risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitization of financial assets. The Company will apply IFRS 7 beginning on January 1, 2013. The Company has completed an analysis of IFRS 7 and do not expect any significant effect on the consolidated financial statements as a result of adopting this standard.

h) IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* was issued by the IASB in October 2011 and provides guidance on the accounting for the costs of stripping activity in the production phase of surface mining when two benefits accrue to the entity from the stripping activity: useable ore that can be used to produce inventory and improved access to further quantities of material that will be mined in future periods. IFRIC 20 will be applied starting January 1, 2013. The Company will amend its accounting policy on production phase stripping costs to require the Karowe Mine to consider components of the pit in the assessment of whether or not a future benefit has been created by the mining activities in the period. The Company expects that this will lead to an increase in the amount of stripping costs that are capitalized over the life of the open pit mine. The Company is in the process of calculating the effect of IFRIC 20 on the comparative consolidated financial statements for all periods of 2012.

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

5. TRADE RECEIVABLES AND OTHER

	2012	2011
VAT	$ 3,033,760	$ 5,933,746
Trade	1,502,718	-
Other	248,069	149,497
Prepayments	742,333	215,019
	$ 5,526,880	$ 6,298,262

6. INVENTORIES

	2012	2011
Rough diamonds	$ 8,444,619	$ -
Ore stockpile	1,797,011	1,597,255
Parts and supplies	3,058,627	-
	$ 13,300,257	$ 1,597,255

Inventory expensed during the year ended December 31, 2012 totaled $14.0 million (2011 – nil).

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

7. PLANT AND EQUIPMENT

Cost	**Construction in progress**	**Mine and plant facilities**	**Vehicles**	**Furniture and office equipment**	**Total**
Balance, January 1, 2011	$ 11,495,024	$ 6,800,639	$ 455,111	$ 288,201	$ 19,038,975
Additions	84,164,797	2,412,460	1,017,022	2,268,944	89,863,223
Disposals and other	-	-	-	(8,103)	(8,103)
Translation differences	(8,939,809)	(1,447,211)	(158,333)	(230,021)	(10,775,374)
Balance, December 31, 2011	86,720,012	7,765,888	1,313,800	2,319,021	98,118,721
Additions	27,070,119	8,027,394	284,355	1,240,659	36,622,527
Disposals and other	861,996	-	(2,065)	(1,128,962)	(269,031)
Translation differences	(1,256,128)	(2,759,463)	(54,065)	(69,863)	(4,139,519)
Reclassification	(113,395,999)	113,395,999	-	-	-
Balance, December 31, 2012	$ -	$ 126,429,818	$ 1,542,025	$ 2,360,855	$130,332,698

Accumulated depreciation					
Balance, January 1, 2011	$ -	$ 1,520,538	$ 2,234	$ 24,164	$ 1,546,936
Depletion, amortization and accretion for the year	-	2,165,316	309,721	166,407	2,641,444
Disposals and other	-	-	-	(690)	(690)
Translation differences	-	(521,490)	(29,572)	(19,152)	(570,214)
Balance, December 31, 2011	-	3,164,364	282,383	170,729	3,617,476
Depletion, amortization and accretion for the year	-	7,921,928	333,683	430,756	8,686,367
Disposals and other	-		-	-	-
Translation differences	-	(334,739)	(18,183)	(13,622)	(366,544)
Balance, December 31, 2012	$	$ 10,751,553	$ 597,883	$ 587,863	$ 11,937,299

Net book value					
As at December 31, 2011	$ 86,720,012	$ 4,601,524	$ 1,031,417	$ 2,148,292	$ 94,501,245
As at December 31, 2012	$ -	$ 115,678,265	$ 944,142	$ 1,772,992	$ 118,395,399

During the year ended December 31, 2012, the Company reduced plant and equipment by $12.8 million relating to diamonds sold during the pre-commercial production period.

Plant and equipment include interest and financing costs relating to the construction of plant and equipment prior to the commencement of commercial production. Interest and financing costs are capitalized only for the project for which funds have been borrowed. Interest expense capitalized in 2012 was $2,533,290 (2011 – 1,262,717).

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

8. MINERAL PROPERTIES

Cost	Karowe Mine	Mothae Diamond	Mothae mining license	Total
Balance, January 1, 2011	$ 64,610,259	$ 20,483,498	$ 4,060,985	$ 89,154,742
Additions	12,959,168	187,518	-	13,146,686
Disposals and other	-	-	-	-
Translation differences	(9,067,150)	(2,445,156)	(746,445)	(12,258,751)
Balance, December 31, 2011	68,502,277	18,225,860	3,314,540	90,042,677
Additions	-	28,613	-	28,613
Disposals and other	(546,779)	-	-	(546,779)
Translation differences	(2,451,361)	(567,359)	(137,432)	(3,156,152)
Balance, December 31, 2012	$ 65,504,137	$ 17,687,114	$ 3,177,108	$ 86,368,359
Accumulated depletion				
Balance, January 1, 2011	$ -	$ -	$ -	$ -
Depletion for the year	-	-	-	-
Disposals and other	-	-	-	-
Translation differences	-	-	-	-
Balance, December 31, 2011	-	-	-	-
Depletion for the year	1,760,598	-	-	1,760,598
Disposals and other	-	-	-	-
Translation differences	(37,488)	-	-	(37,488)
Balance, December 31, 2012	$ 1,723,110	$ -	$ -	$ 1,723,110
Net book value				
As at December 31, 2011	$ 68,502,277	$ 18,225,860	$ 3,314,540	$ 90,042,677
As at December 31, 2012	$ 63,781,027	$ 17,687,114	$ 3,177,108	$ 84,645,249

8. MINERAL PROPERTIES (continued)

a) Karowe Mine

In December 2009, the Company, through a newly created indirect wholly-owned subsidiary Boteti Diamond Holdings Inc. ("Boteti Holdings"), acquired an initial 70.268% interest in the Boteti Mining (PTY) Ltd. ("Boteti"), from De Beers Prospecting Botswana (Pty) Limited ("De Beers"), for consideration of $49 million. The remaining interest in Boteti was held as to 28.381% by African Diamonds PLC ("African Diamonds") and indirectly by Wati Ventures (Pty) Ltd. ("Wati Ventures") as to 1.351%. Boteti Holdings had granted an option to African Diamonds to increase its interest in Boteti by a further 10.268% by making a cash payment of approximately US$7.3 million, which was exercised in April 2010. After the exercise of the option, Boteti was held 60% by the Company and 40% by African Diamonds. In December 2010, the Company acquired the 40% non-controlling interest.

A royalty of 10% of the sales value of diamonds produced from Karowe will be payable to the government of Botswana.

b) Mothae Diamond Project

Pursuant to the terms of the mining agreement, Mothae Diamonds, an indirect 75% owned subsidiary of the Company has a 100% interest in the project. The remaining 25% of Mothae Diamonds is held by the Government of Lesotho (Note 13). 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 has been paid to the government. At full production the royalty will increase to 8% of diamond sales value. The mining lease is valid until September 2019 and renewable for an additional 10 years.

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

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

9. LONG-TERM DEBT

	2012	2011
Debenture (a)		
Principal	$ 50,000,000	$ 50,000,000
Unamortized discount	(3,179,473)	(8,185,342)
Revolving credit facility (b)	4,500,000	-
Deferred finance charges (b)	(366,520)	-
	50,954,007	41,814,658
Less: Current portion	(30,310,587)	(10,950,493)
Long-term portion of long-term debt	$ 20,643,420	$ 30,864,165

a) *Debenture*

In July 2011, the Company secured a $50 million debenture to fund the development of the Company's projects. In July 2012, the Company renegotiated the terms of the debenture resulting in quarterly repayments of $8.3 million commencing March 31, 2013 and a final maturity date of June 30, 2014. No interest is payable during the term of the facility.

The Company has pledged shares in the subsidiaries that control the companies that own the projects as security over the facility. The facility has been issued by Zebra Holdings and Investments S.a.r.l ("Zebra") and Lorito Holdings S.a.r.l ("Lorito"), each an investment company owned by a trust settled by the late Adolf H. Lundin, and not a related party of the Company.

The terms of the debenture financing also included the Company issuing an aggregate of 9 million common shares (fair value $10.7 million) to Zebra and Lorito as consideration for the facility, in lieu of interest and fees. During the year, accretion of $5.0 million was recorded of which $2.5 million has been capitalized in plant and equipment (Note 7).

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

As at December 31, 2012	Current portion	Long-term portion	Total
Principal	$ 33,333,334	$ 16,666,666	$ 50,000,000
Unamortized discount	(2,729,209)	(450,264)	(3,179,473)
Total carrying value	$ 30,604,125	$ 16,216,402	$ 46,820,527

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

9. LONG-TERM DEBT (continued)

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

b) Revolving credit facility

In April 2012, the Company signed a definitive agreement with the Bank of Nova Scotia for a $25 million revolving term credit facility with a maturity date of March 26, 2014, which may be extended if both parties agree. Funds drawn under the revolving credit facility are due in full at maturity. The facility contains financial and non-financial covenants customary for a facility of this size and nature. As at December 31, 2012, the Company is in compliance with all financial and non-financial covenants. Outstanding amounts under the facility bear interest at LIBOR or an alternative base rate plus an applicable margin based on the Company's leverage ratio.

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

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

As at December 31, 2012, the Company has drawn $4.5 million from the credit facility. Deferred finance charges of $0.4 million have been netted against this drawdown relating to the set-up of the facility.

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

10. RESTORATION PROVISIONS

The Company's restoration provisions relate to the rehabilitation of its diamond properties. The provisions have been calculated based on total estimated rehabilitation costs and discounted back to their present values. The pre-tax discount rates and inflation rates are adjusted annually and reflect current market assessments. The Company has applied a pre-tax discount rate of 10.4% at December 31, 2012 (10.0% at December 31, 2011) and an inflation rate of 6.2% at December 31, 2012 (6% at December 31, 2011) at the Karowe Mine project. The Company has applied a pre-tax discount rate of 9.9% at December 31, 2012 (11.0% at December 31, 2011) and an inflation rate of 6.1% at December 31, 2012 (6.0% at December 31, 2011) at its Mothae Diamond Project. The rehabilitation costs are expected to be incurred in the period of 2022 to 2024. The estimated total liability for reclamation and remediation costs on an undiscounted basis is approximately $16.9 million (December 31, 2011 - $17.5 million).

	2012	2011
Balance, beginning of year	$ 12,485,650	$ 567,697
Fair value of obligation recorded during the year	-	12,959,168
Revisions to estimated cash flows	(1,069,562)	187,518
Accretion of liability component of obligation	1,284,166	70,583
Foreign currency translation adjustment	(458,630)	(1,299,316)
Balance, end of year	12,241,624	12,485,650
Less: Current portion	-	-
Long-term portion of restoration provisions	$ 12,241,624	$ 12,485,650

11. SHARE CAPITAL

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

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

In July 2011, 9.0 million common shares with a fair value of $10.7 million were issued Zebra and Lorito as consideration for the $50.0 million debenture (Note 9).

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

12. STOCK OPTIONS

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

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

	Number of shares issuable pursuant to stock options	Weighted average exercise price per share (CDN$)
Balance at December 31, 2010	**11,550,000**	**$ 0.91**
Granted	1,525,000	0.84
Forfeited	(168,330)	0.95
Expired	(20,000)	0.77
Exercised	(854,999)	0.71
Balance at December 31, 2011	**12,031,671**	**0.93**
Granted	150,000	1.03
Forfeited	(391,671)	0.90
Expired	(5,181,300)	1.13
Exercised	(3,943,700)	0.70
Balance at December 31, 2012	**2,665,000**	**$ 0.88**

The weighted average share price of options exercised during the year was $0.88.

Options to acquire common shares have been granted and are outstanding at December 31, 2012 as follows:

	Outstanding Options			**Exercisable Options**		
Range of exercise prices CDN$	Number of options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price CDN$	Number of options exercisable	Weighted average remaining contractual life (years)	Weighted average exercise price CDN$
$0.80 - $0.85	1,450,000	1.5825	$ 0.81	1,074,977	1.4694	$ 0.81
$0.86 - $0.90	75,000	0.4219	0.87	75,000	0.4219	0.87
$0.91 - $0.95	465,000	0.9534	0.95	465,000	0.9534	0.95
$0.96 - $1.00	600,000	1.0954	0.99	449,992	0.8332	0.99
$1.01 - $1.25	75,000	1.8749	1.17	33,331	1.7397	1.19
	2,665,000	1.3387	$ 0.88	2,098,300	1.1855	$ 0.89

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

12. STOCK OPTIONS (continued)

During the year ended December 31, 2012, an amount of $285,843 (2011 – $609,705) was charged to operations in recognition of stock-based compensation expense, based on the vesting schedule for the options granted.

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

	2012	**2011**
Assumptions:		
Risk-free interest rate *(%)*	1.03	1.12
Expected life *(years)*	3.00	3.00
Expected volatility *(%)*	51.23	57.95
Expected dividend	Nil	Nil
Results:		
Weighted average fair value of options granted *(per option)*	$ 0.35	$ 0.32

13. NON-CONTROLLING INTERESTS

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

The GOL's equity interest must be kept at 25% and cannot be diluted by further equity issuances. As such, the 12.5% free-carried interest portion of the Company's capital contributions into Mothae is accounted for as an equity transaction between shareholders.

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

14. EXPLORATION EXPENDITURES

December 31, 2012	Mothae Diamond	Karowe Mine	Total
Test mining	$ 7,928,418	$ -	$ 7,928,418
Depreciation	3,262,043	-	3,262,043
Resource development	1,869,681	-	1,869,681
Geology	651,996	-	651,996
Office and other	621,172	-	621,172
Environmental impact assessment	-	-	-
Feasibility study	-	-	-
Diamonds recovered	(1,479,464)	-	(1,479,464)
	$ 12,853,846	$ -	$ 12,853,846

December 31, 2011	Mothae Diamond	Karowe Mine	Total
Test mining	$ 10,445,720	$ -	$ 10,445,720
Depreciation	2,227,902	354,445	2,582,347
Resource development	327,296	-	327,296
Geology	745,336	-	745,336
Office and other	602,717	11,864	614,581
Environmental impact assessment	232,003	-	232,003
Feasibility study	-	(393,402)	(393,402)
Diamonds recovered	(7,935,648)	-	(7,935,648)
	$ 6,645,326	$ (27,093)	$ 6,618,233

15. ADMINISTRATION

	2012	2011
Salaries and benefits	$ 4,650,856	$ 2,006,047
Stock exchange, transfer agent, shareholder communication	1,575,075	1,729,076
Office and general	1,037,550	243,999
Travel	740,917	703,773
Professional fees	574,811	1,762,571
Management fees	504,202	505,850
Stock based compensation	285,843	609,705
Depreciation	146,012	59,096
Donations	19,008	562,505
	$ 9,534,274	$ 8,182,622

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

16. GAIN ON SALE OF DIAMONDS

During the year ended December 31, 2012, Mothae Diamonds held one diamond sale and received gross proceeds of $1.5 million. The proceeds on this sale have been netted against exploration expenditures (Note 14).

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

17. INCOME TAXES

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

	2012	2011
Basic statutory tax rate	25%	26.5%
Net loss before taxes	7,524,801	18,673,892
Computed income tax recovery	1,881,200	4,948,581
Differences between Canadian and foreign tax rates	748,882	(115,852)
Non-deductible expenses	(71,461)	(161,572)
Change in future tax rates	(846,528)	(134,730)
Change in deferred benefits not recognized	(1,104,013)	(4,259,366)
Exchange rate differences	(655,394)	(601,338)
Other	47,314	324,277
	$ -	$ -

The Canadian statutory tax rate decreased to 25% due to legislated changes. The Company did not recognize its deferred tax assets as it is not considered probable that they will be utilized and has no deferred tax liabilities. The movement in deferred tax assets during the year, without taking into consideration the offsetting balances within the same tax jurisdiction, is as follows:

Deferred income tax assets/(liabilities) recognized	2012	2011
Plant and equipment	$ (29,065,886)	$ -
Tax loss carry forwards	29,065,886	-
Net deferred income tax assets	$ -	$ -

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

17. INCOME TAXES (continued)

Deferred income tax assets not recognized	2012	2011
Tax losses	$ 26,383,210	$ 13,286,539
Resource pools	97,185	95,963
Other deductible temporary differences	601,267	1,827,666
	$ 27,081,662	$ 15,210,168

As at December 31, 2012, the Company has non-capital losses for income tax purposes as follows:

	2013	2014	2015	Subsequent to 2016	No expiry date	Total
Canada	$ -	$ -	$ 1,196,627	$ 36,682,287	$ -	$ 37,878,914
Botswana	-	-	-	-	153,799,509	153,799,509
Lesotho	-	-	-	-	23,910,708	23,910,708
	$ -	$ -	$ 1,196,627	$ 36,682,287	$177,710,217	$ 215,589,131

Future tax benefits which may arise as a result of these non-capital losses have not been recognized in these financial statements.

18. LOSS PER COMMON SHARE

a) Basic

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

	2012	2011
Loss for the year – attributable to Shareholders of the Company	$ (5,910,917)	$ (18,126,567)
Weighted average number of common shares outstanding	374,621,554	360,019,710
	$ (0.02)	$ (0.05)

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

18. LOSS PER COMMON SHARE (continued)

b) Diluted

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

	2012	2011
Loss for the year – attributable to Shareholders of the Company	$ (5,910,917)	$ (18,126,567)
Weighted average number of common shares outstanding	374,621,554	360,019,710
Adjustment for stock options	-	-
Weighted average number of common shares for diluted earnings per share	374,621,554	360,019,710
	$ (0.02)	$ (0.05)

19. RELATED PARTY TRANSACTIONS

a) Related party expenses

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

Description of services	Related party	2012	2011
Management fees	Namdo	$ 504,202	$ 505,850
Donations	LF	-	607,020
Exploration related expenditures	MS Group	1,915,835	125,598
Aircraft charter	Mile High	381,897	-
		$ 2,801,934	$ 1,238,468

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

19. RELATED PARTY TRANSACTIONS (continued)

b) Related party liabilities

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

	2012	2011
Namdo	$ 37,919	$ -
MS Group	54,435	-
	$ 92,354	$ -

c) Key management compensation

Key management personnel are those persons having the authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly. Key management personnel include the Company's executive officers, vice-presidents and members of its Board of Directors.

The remuneration of key management personnel were as follows:

	2012	2011
Salaries and wages	$ 1,407,563	$ 1,253,718
Short term benefits	111,836	50,679
Stock based compensation	185,516	439,100
	$ 1,704,915	$ 1,743,497

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

20. SEGMENT INFORMATION

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

2012

	Karowe Mine	Mothae Diamond Project	Corporate and other	Total
Revenues	$ 41,830,289	$ -	$ -	$ 41,830,289
Income from mining operations	17,849,625	-	(92,124)	17,757,501
Exploration expenditures	-	(12,853,846)	-	(12,853,846)
Gain on sale of diamonds	-	-	-	-
Finance expenses	154,943	(72,185)	(3,185,334)	(3,102,576)
Other income (expenses)	(2,349,778)	14,956	(6,991,058)	(9,325,880)
Net loss for the year	15,654,790	(12,911,075)	(10,268,516)	(7,524,801)
Capital expenditures	(44,440,839)	-	-	(44,440,839)
Total assets	207,037,728	12,468,289	15,845,523	235,351,540

2011

	Karowe Mine	Mothae Diamond Project	Corporate and other	Total
Revenues	$ -	$ -	$ -	$ -
Income from mining operations	-	-	-	-
Exploration expenditures	27,093	(6,645,326)	-	(6,618,233)
Gain on sale of diamonds	-	2,339,282	-	2,339,282
Finance expenses	(619,881)	(70,583)	(1,164,064)	(1,854,528)
Other income (expenses)	(1,726,674)	(1,972)	(10,811,767)	(12,540,413)
Net loss for the year	(2,319,462)	(4,378,599)	(11,975,831)	(18,673,892)
Capital expenditures	(74,443,036)	(1,510,489)	(1,237,882)	(77,191,407)
Total assets	182,567,375	21,757,150	36,962,856	241,287,381

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

	Plant and equipment 2012	Plant and equipment 2011	Mineral properties 2012	Mineral properties 2011	Other 2012	Other 2011
Canada	$ 208,953	$ 259,925	$ -	$ -	$ -	$ 7,766
Lesotho	1,369,478	4,751,648	20,864,222	21,540,400	136,754	141,747
Botswana	116,816,968	89,489,672	63,781,027	68,502,277	-	-
	$ 118,395,399	$ 94,501,245	$ 84,645,249	$ 90,042,677	$ 136,754	$ 149,513

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

21. FINANCIAL INSTRUMENTS

a) Measurement categories and fair values

As explained in Note 3, financial assets and liabilities have been classified into categories that determine their basis of measurement and, for items measured at fair value, whether changes in fair value are recognized in the consolidated statements of operations or consolidated statements of comprehensive loss. Those categories are: fair value through profit or loss; loans and receivables; available for sale assets; and, for liabilities, amortized cost.

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

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

	December 31, 2012	December 31, 2011
ASSETS		
Loans and receivables		
Cash	$ 13,261,484	$ 22,750,599
Cash equivalents	-	25,838,810
	13,261,484	48,589,409
Trade receivables	1,502,718	-
Other receivables	248,069	149,497
	$ 15,012,271	$ 48,738,906
Available for sale		
Investments	85,517	109,020
	$ 85,517	$ 109,020
LIABILITIES		
Amortized cost		
Trade payables	$ 7,429,283	$ 11,483,887
Accrued liabilities	7,265,474	5,151,945
	14,694,757	16,635,832
Long-term debt	50,954,007	41,814,658
	$ 65,648,764	$ 58,450,490

21. FINANCIAL INSTRUMENTS (continued)

b) Fair value hierarchy

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

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

	December 31, 2012	December 31, 2011
Level 1		
Investments	$ 85,517	$ 109,020
Level 2 and Level 3 – N/A		

c) Financial risk management

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

Commodity price risk

The Company is subject to commodity price risk. Diamonds are not a homogenous product and the price of rough diamonds is not monitored on a public index system. The fluctuation of prices is related to certain features of diamonds such as quality and size. Diamond prices are marketed in U.S. dollars and long term U.S. dollar per carat prices are based on external market consensus forecasts. The Company does not have any financial instruments that may fluctuate as a result of commodity price movements.

Currency risk

The Company is exposed to the financial risk related to fluctuating foreign exchange rates. All sales revenues are denominated in U.S. dollars, while directly related costs are denominated in Botswana Pula. At December 31, 2012, the Company is exposed to currency risk relating to trade receivables denominated in U.S. dollars within the Company's Botswana entity. Based on this exposure, a 10% change in the Botswana Pula/U.S. dollar exchange rate would give rise to an increase/decrease of approximately $0.2 million in net income for the year.

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

21. FINANCIAL INSTRUMENTS (continued)

To minimize the risk exposure of foreign currency fluctuations on sales revenues, the Company has entered into forward exchange contracts to fix the rate at which future anticipated flows of U.S. dollars are exchanged into Botswana Pula. At December 31, 2012, these contracts included forward sales of U.S. dollars at an average rate of 7.8244 Botswana Pula per U.S. dollar, in the aggregate amount of $8.0 million from March 2013 to May 2013. The unrealized loss recorded on these contracts at December 31, 2012 was $0.1 million.

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. Considering the nature of the Company's ultimate customers and the relevant terms and conditions entered into with such customers, the Company believes that credit risk is limited as customers pay on receipt of goods.

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

Liquidity risk (Note 22)

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

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

December 31, 2012	Less than 3 months	3 months to 1 year	2-5 years	Over 5 years
Trade payables and accrued liabilities	$ 14,694,757	$ -	$ -	$ -
Long-term debt	-	33,333,334	21,166,666	-

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

21. FINANCIAL INSTRUMENTS (continued)

Interest rate risk

The Company's exposure to interest rate risk results from the effects that changes in interest rates may have on the reported value of cash and cash equivalents. There is minimal risk that the Company would recognize any loss as a result of a decrease in the fair value of any short-term investments included in cash and cash equivalents due to their short-term nature. Based on the balance of cash and cash equivalents at December 31, 2012, and assuming that all other variables remain constant, a 0.25% change in the U.S. prime rate would result in an increase/decrease of $33,154 in the interest accrued by the Company per annum.

Equity market risk

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

22. CAPITAL MANAGEMENT

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

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

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

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

The Company's consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due.

In July 2011, the Company secured a $50 million debenture (the "debenture") to fund the development of the Company's projects. The debenture has been issued by Zebra Holdings and Investments S.a.r.l ("Zebra") and Lorito Holdings S.a.r.l ("Lorito"), each an investment company owned by a trust settled by the late Adolf H. Lundin, and not a related party of the Company. Zebra and Lorito hold a total of 60,000,000 common shares of the Company, which represent approximately 16.1% of the current outstanding common shares.

22. CAPITAL MANAGEMENT (continued)

In July 2012, the Company renegotiated the terms of the debenture resulting in quarterly repayments of $8.3 million commencing March 31, 2013 and a final maturity date of June 30, 2014. No interest is payable during the term of the facility. The Company's ability to repay the quarterly instalment payments on its debenture depends on a number of factors, some of which are beyond the Company's control, including the global economy and the demand for and selling price of our diamonds.

The Company is anticipated to pay the first quarterly instalment payment due March 31, 2013. However, market weakness may impact the company's ability to make its quarterly debenture payments. Although the Company has a $25 million revolving credit facility, under the terms of this facility, it cannot be used to repay the debenture.

The Company will continue to monitor and forecast its expected cash flow from operations. However, should factors beyond the Company's control worsen, the Company will begin discussions with Zebra and Lorito to negotiate amendments to the debenture to provide the Company with additional time to generate cash and/or access appropriate sources of long-term financing to repay the debenture. Although the Company has been successful in renegotiating the debenture in the past, there can be no assurance that the Company will be successful again.

23. CONTINGENCIES

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

In September 2011, the Company was notified that the plaintiffs, in the legal proceedings initiated against AFD, had filed an appeal of the decision of the High Court of Botswana dismissing the plaintiff's claims with costs awarded in favor of AFD. At this stage the Company does not have any further details as to the timing of when the Appeal will be heard.

24. SUBSEQUENT EVENTS

The Company entered into a series of forward exchange contracts to fix the rate at which future anticipated cash flows in U.S. dollars are exchanged in Botswana Pula. Such contracts include forward sales of U.S. dollars at an average rate of 7.9581 Botswana Pula per U.S. dollar, in the aggregate amount of $43.3 million from February 2013 to December 2013. As a result, the Company's outstanding forward exchange contracts totalled $51.4 million at an average rate of 7.9369 Botswana Pula per U.S dollar.