Financing Diamond Projects

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BOTSWANA DIAMONDS PLC

Financing Diamond Projects

Outline

- Preamble
- Diamond industry fundamentals
- Prospectivity
- Risk management
- Trends in exploration spend
- Junior development funding
- Discussion & Conclusions

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Preamble

The world-class mine that almost never was

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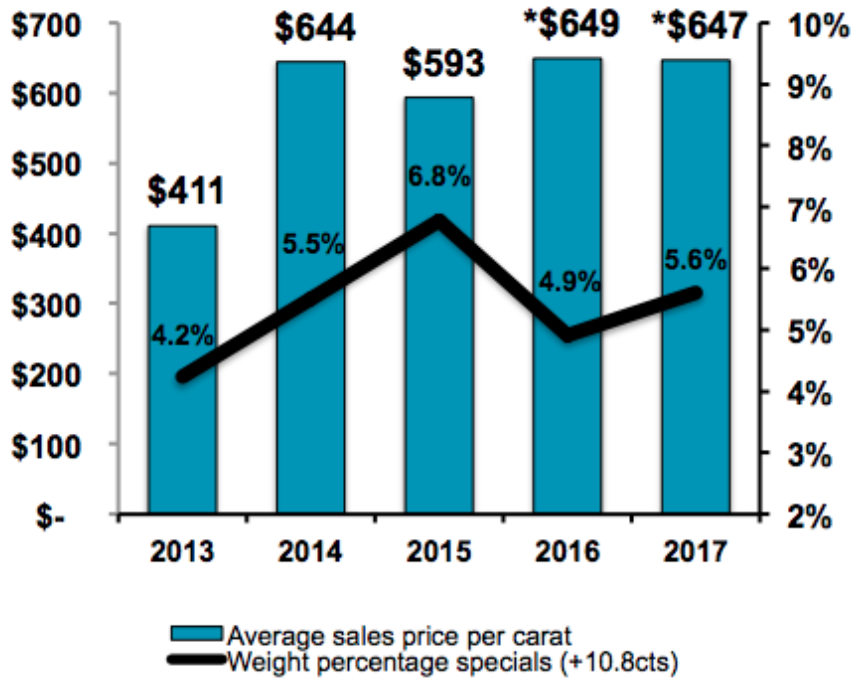
AK6 – Karowe Mine

- 1.8 million carats produced
- USD 1.02 Bn revenue
- USD 218 M dividends paid since 2014
- Possible underground extension

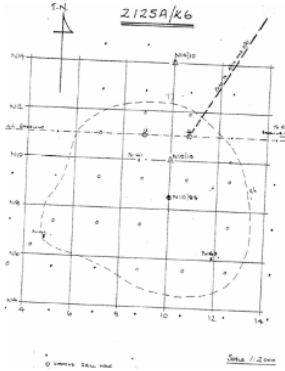


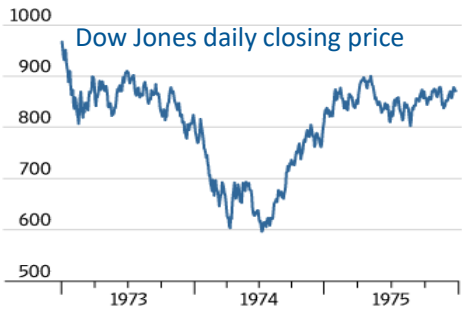
- Exceptional producer of large Type IIa diamonds
- Specials (+10.8ct) exceed $100,000 ct
- 154 diamonds sold for over $1M each

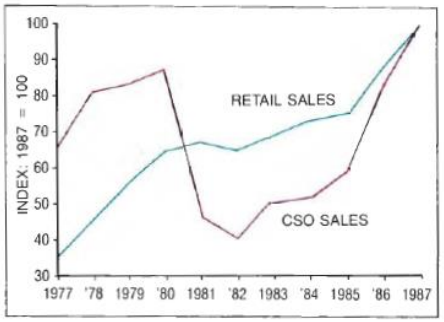
An eventful timeline

BOTSWANA DIAMONDS PLC

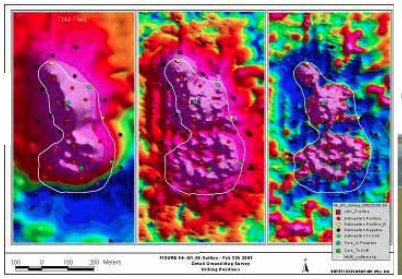
1970's-80's



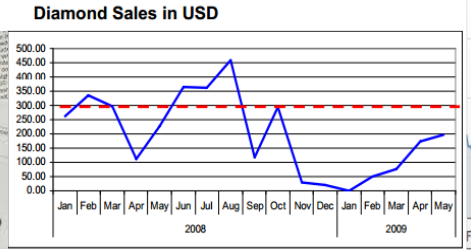




2000's



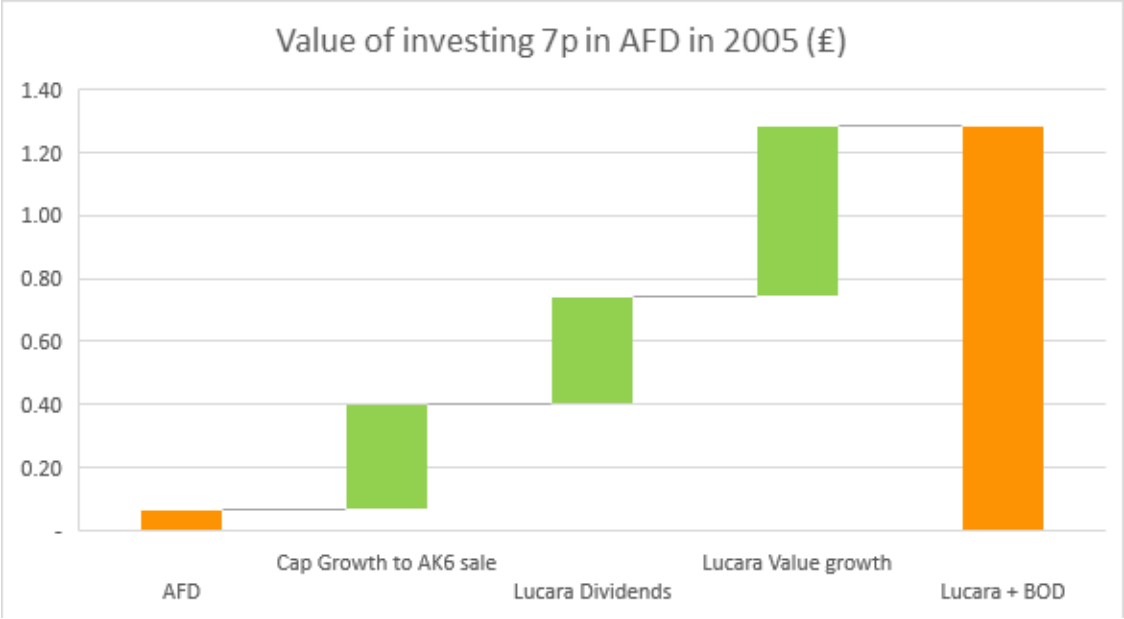
Post-2008



Source: Campbell. 2017

Early gains and long-term value

Share price growth from one AFD share on listing (2005)



- AFD listed in 2005 at 7p, exchanged in 2010 for 1 share in BOD and 0.80 in Lucara
- Two other investment alternatives are presented:
  - Alternative 1: 7p invested in 2005 and subsequent rights followed; and
  - Alternative 2: 40p invested in 2010 immediately prior to the sale of AK6 to Lucara, and the creation of BOD

Table of returns	Base	Alt 1	Alt 2
IRR :			
- Lucara current $2.01	29.4%	24.3%	20.4%
- Lucara peak $2.91	32.1%	27.8%	25.3%
Value multiple*:			
- Lucara current $2.01	18.35	6.20	3.25
- Lucara peak $2.91	24.30	8.21	4.31

* ((divs + capital returned)/investment)

- Early investors extracted substantial value from AFD share price growth
- Would AK6 be Karowe today, were it not for 'Friends, Family & Fools'?
- Cash is king!
- **<u>Fast-forward more than ten years: have things changed?</u>**

Diamond industry fundamentals

Top 25 global diamond assets: concentrated in the hands of a few players

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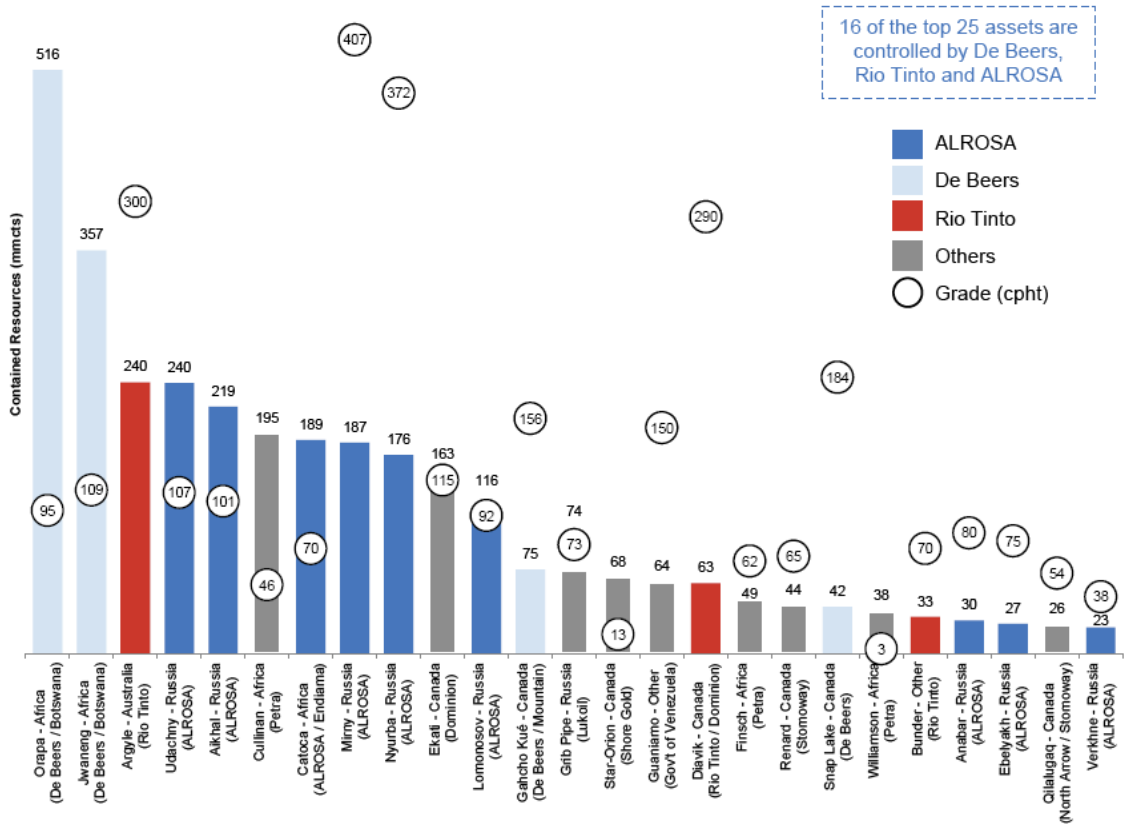
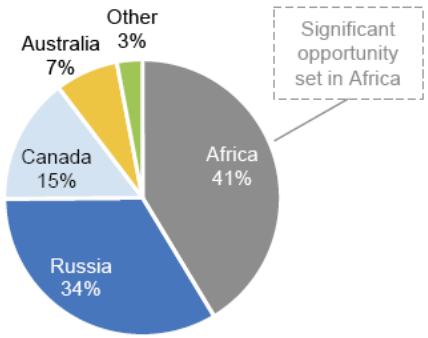
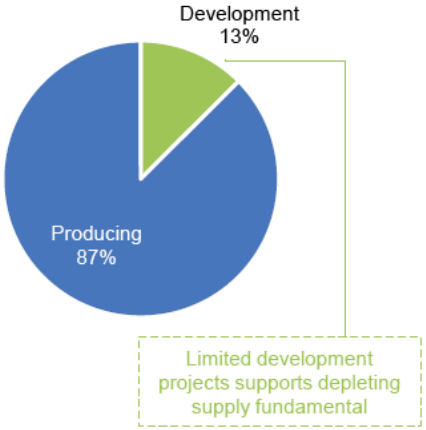
TOP 25 GLOBAL DIAMOND ASSETS BY SIZE



REGION BREAKDOWN – TOP 25 ASSETS[1]



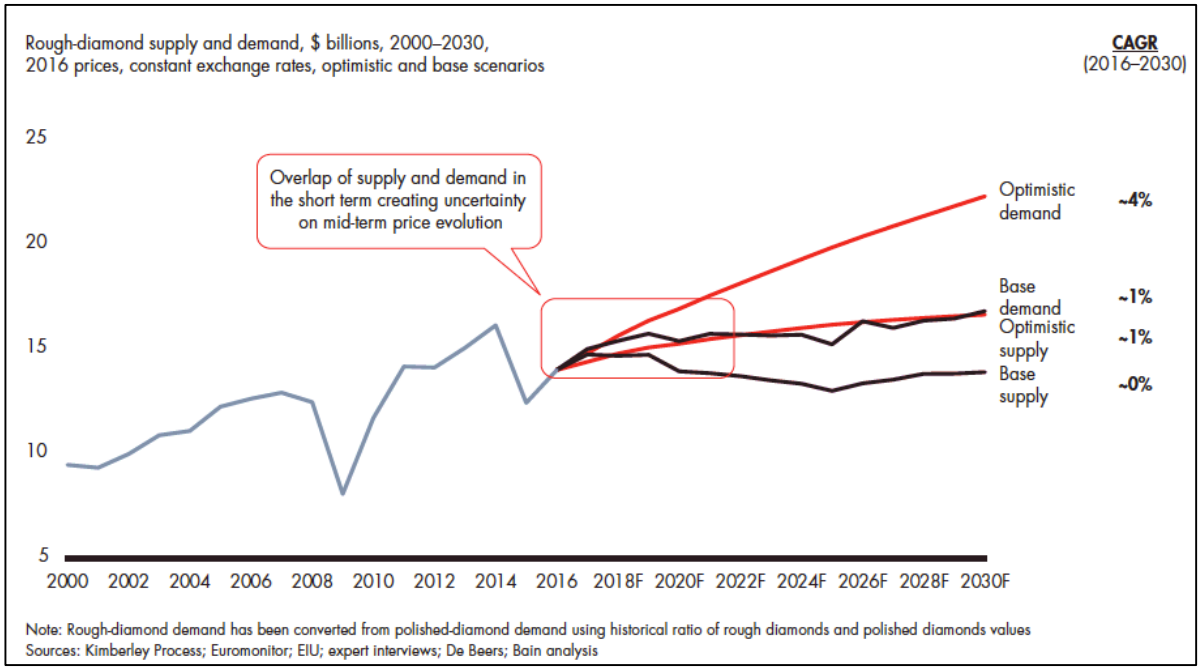
STAGE BREAKDOWN – TOP 25 ASSETS[1]



Diamond resources are concentrated under the control of major producers and located primarily in Africa, Russia and Canada

Source: BMO Capital Markets

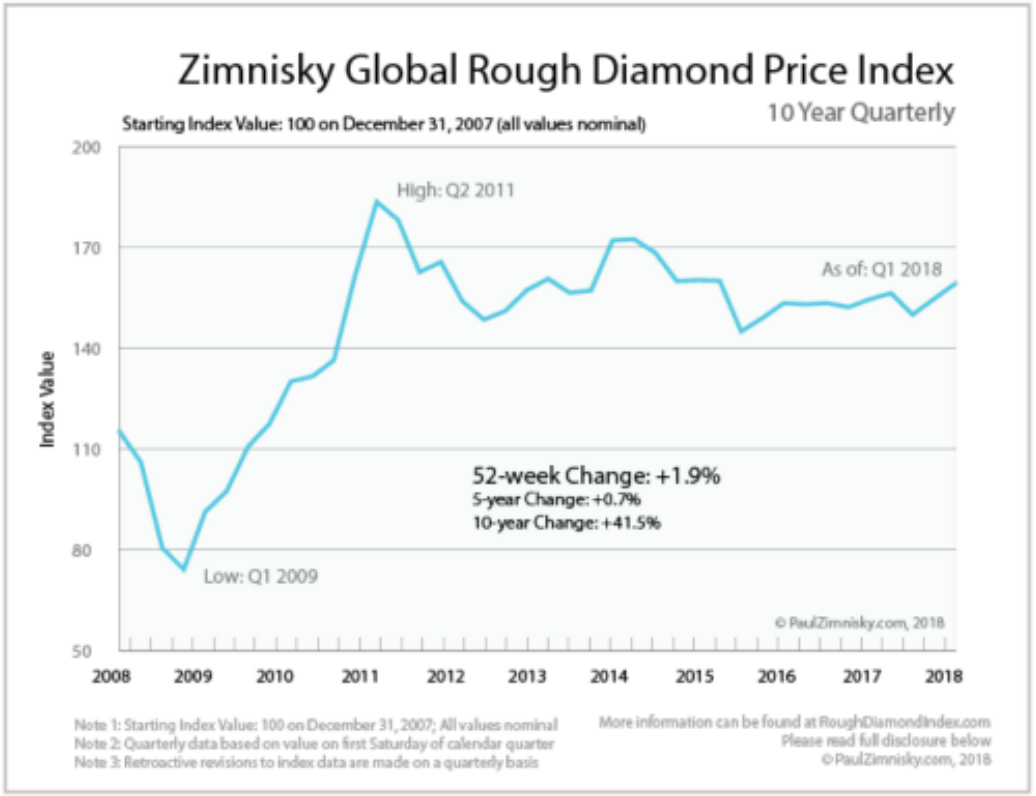
Supply & demand



- Positive ('modestly optimistic') long-term outlook: rough diamond supply predictable and stable until 2030; rough diamond demand expected to grow 1-4% per annum
- Continued growth of middle class in China and India underpins growth forecast
- Key challenges: competition from other luxury goods; impact of laboratory-grown diamonds; financial stability of the midstream segment
- Rough diamond producers boosting investment in generic and branded marketing

Source: Bain & co., 2017

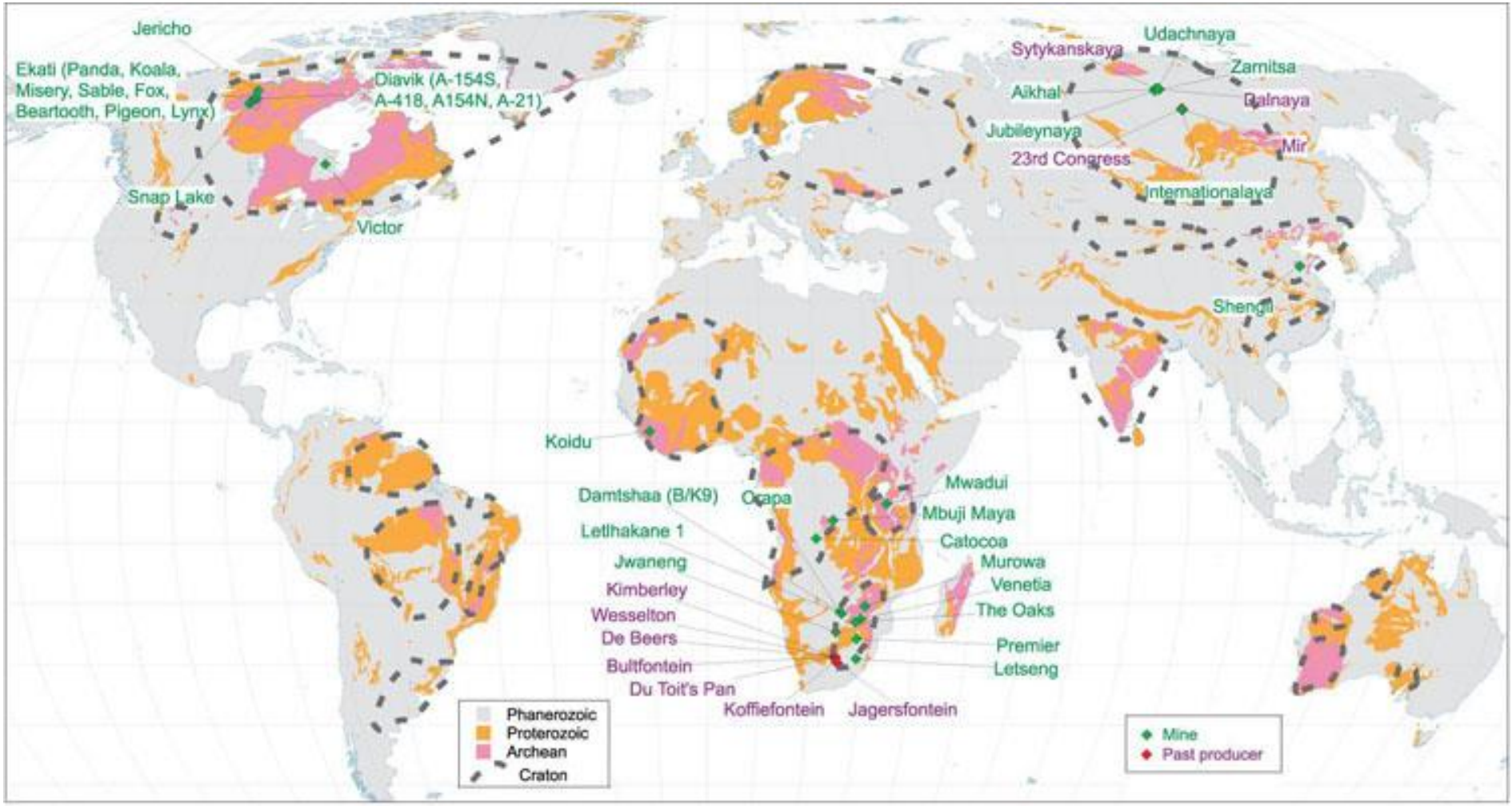
Price stability



- Diamond prices fundamentally driven by supply-demand dynamics and economic growth
- Fastest commodity to recover following the GFC
- Less prone to volatility than mainstream commodities, albeit more volatile lately
- Rough diamond prices expected to continue outperforming gold in years ahead
- Diamonds attracting interest as an investment category

Prospectivity

Diamonds: cratons and mines

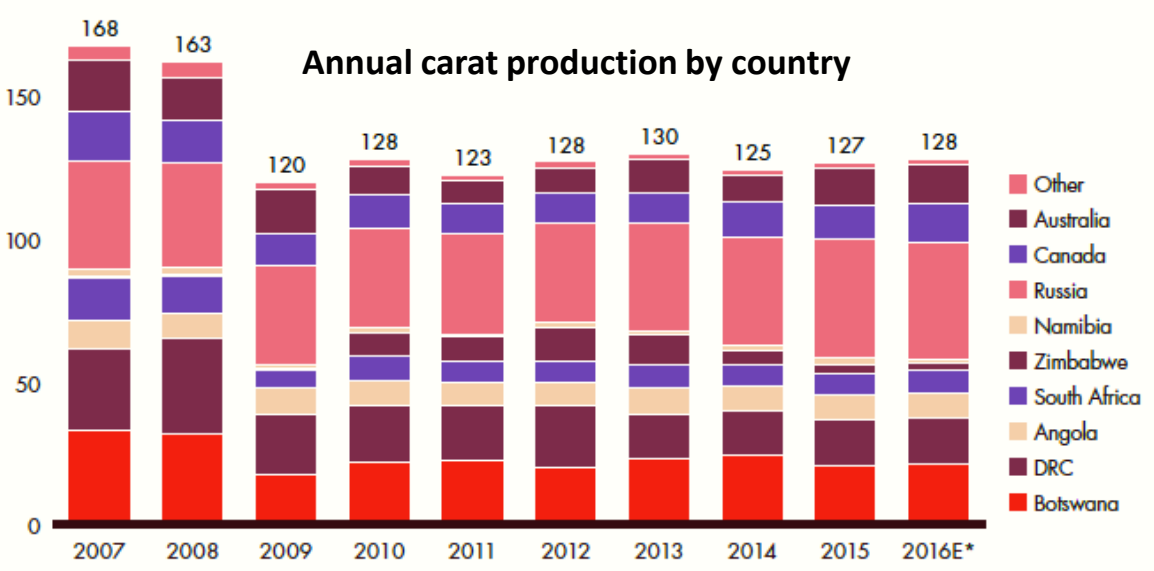


Global distribution of kimberlite hosted diamond mines and major Archean cratons.

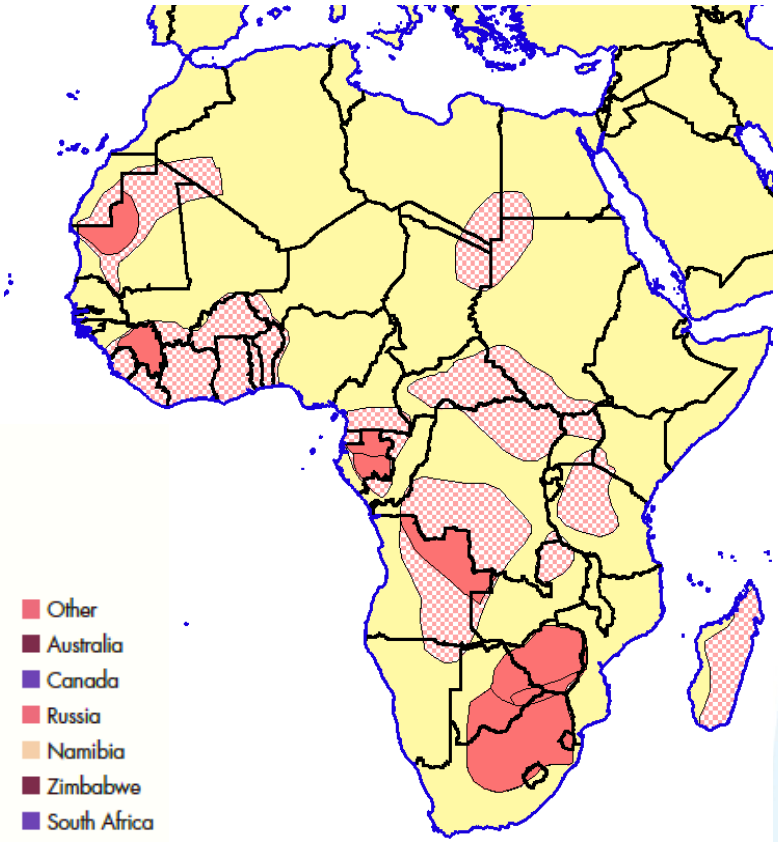
Source: Geological Survey of Canada

What diamond explorers look for

- **<u>Prospectivity</u>**
- Track record of economic production
- Security of tenure
- Transparent mining regulation



Modified after Bain & co., 2017



Craton map modified after Campbell, 2003

What investors look for

Prospectivity, and then:

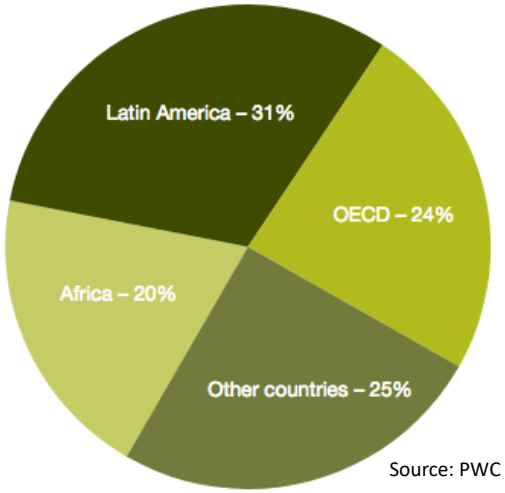
- Stable democracy
- Continued political stability
- Good governance
- Prudent economic and natural resource management
- High credit rating
- Consistent economic growth rates
- Security of investment
- Incentives for local investors (e.g. Canadian flow-through options)

Country risk map adapted from: Euler Hermes 2017

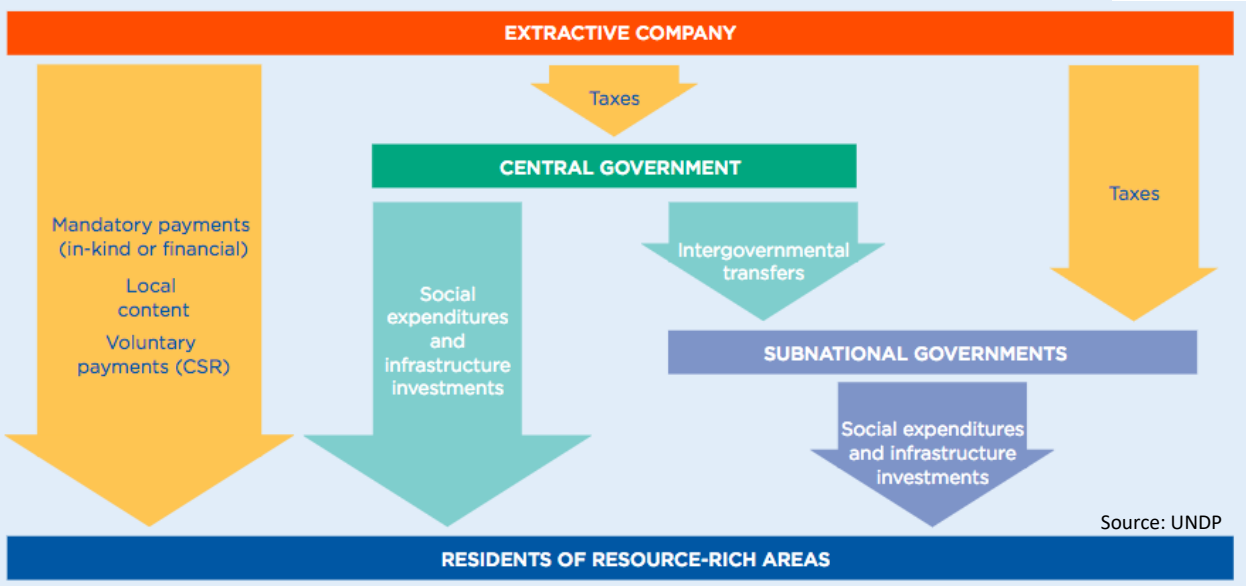
What governments look for

- Revenue: taxes
- Job creation
- Community development
- Beneficiation
- Resource nationalism
- Procurement
- Sustainability

Total contribution to governments by mining companies

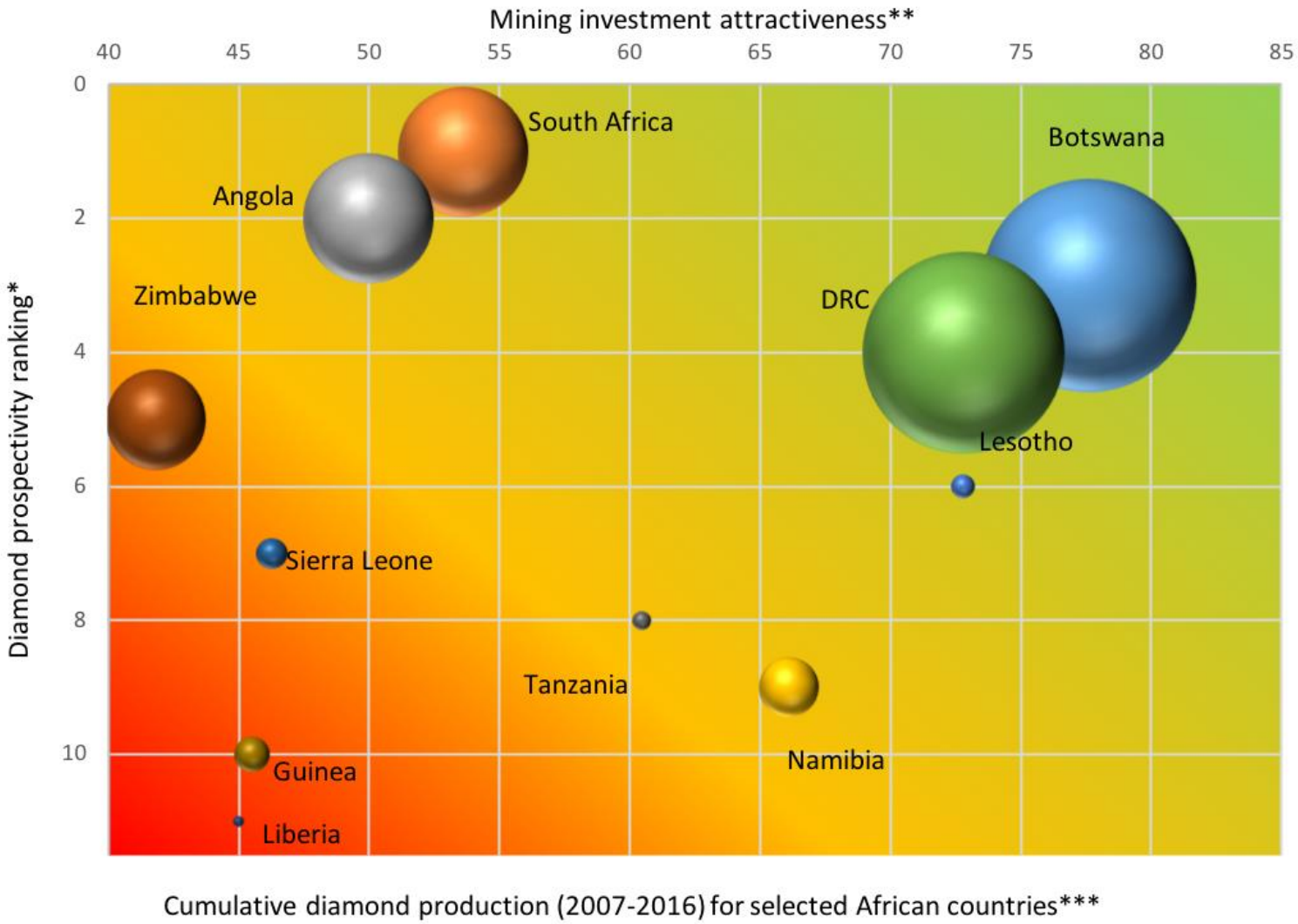


Source: PWC



Source: UNDP

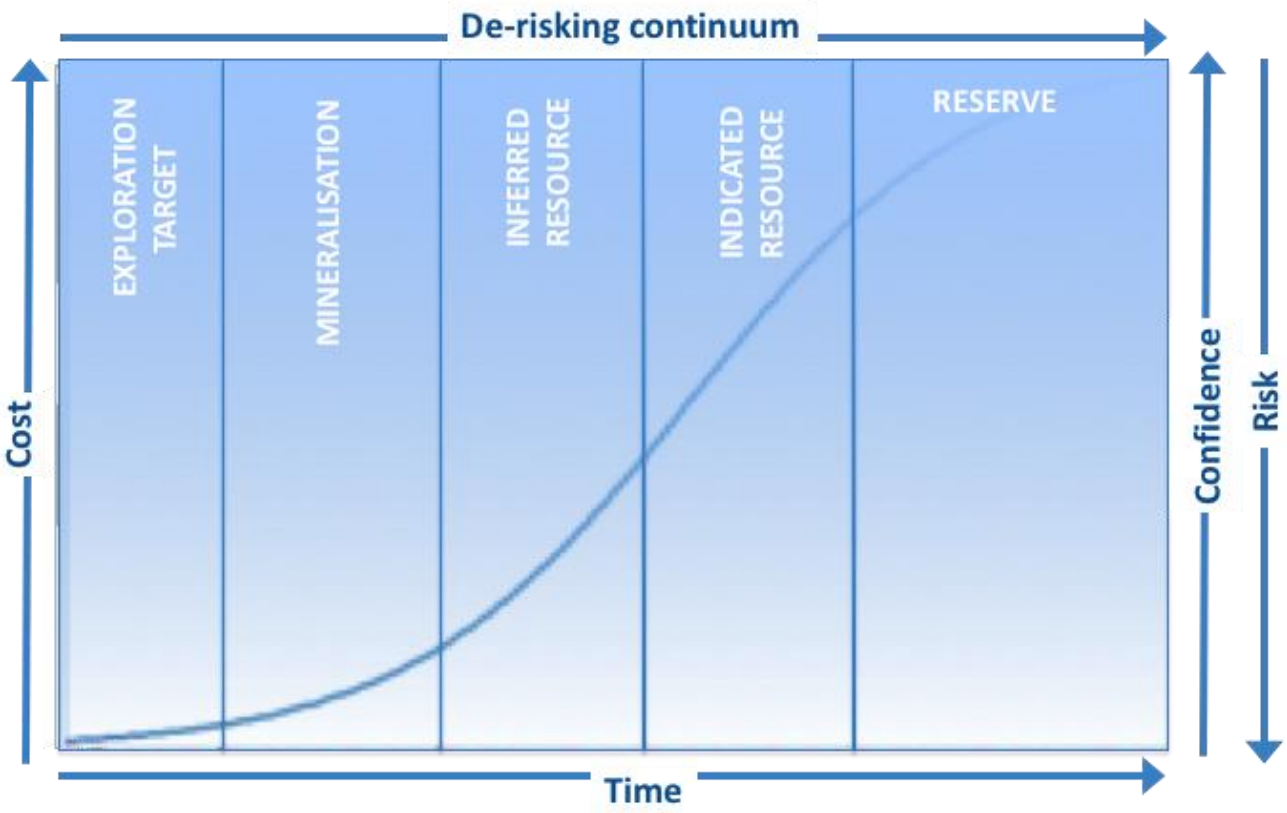
Prospectivity & mining attractiveness



*Author's own research, **Adapted from Fraser Institute, 2016, *** Kimberley Process data

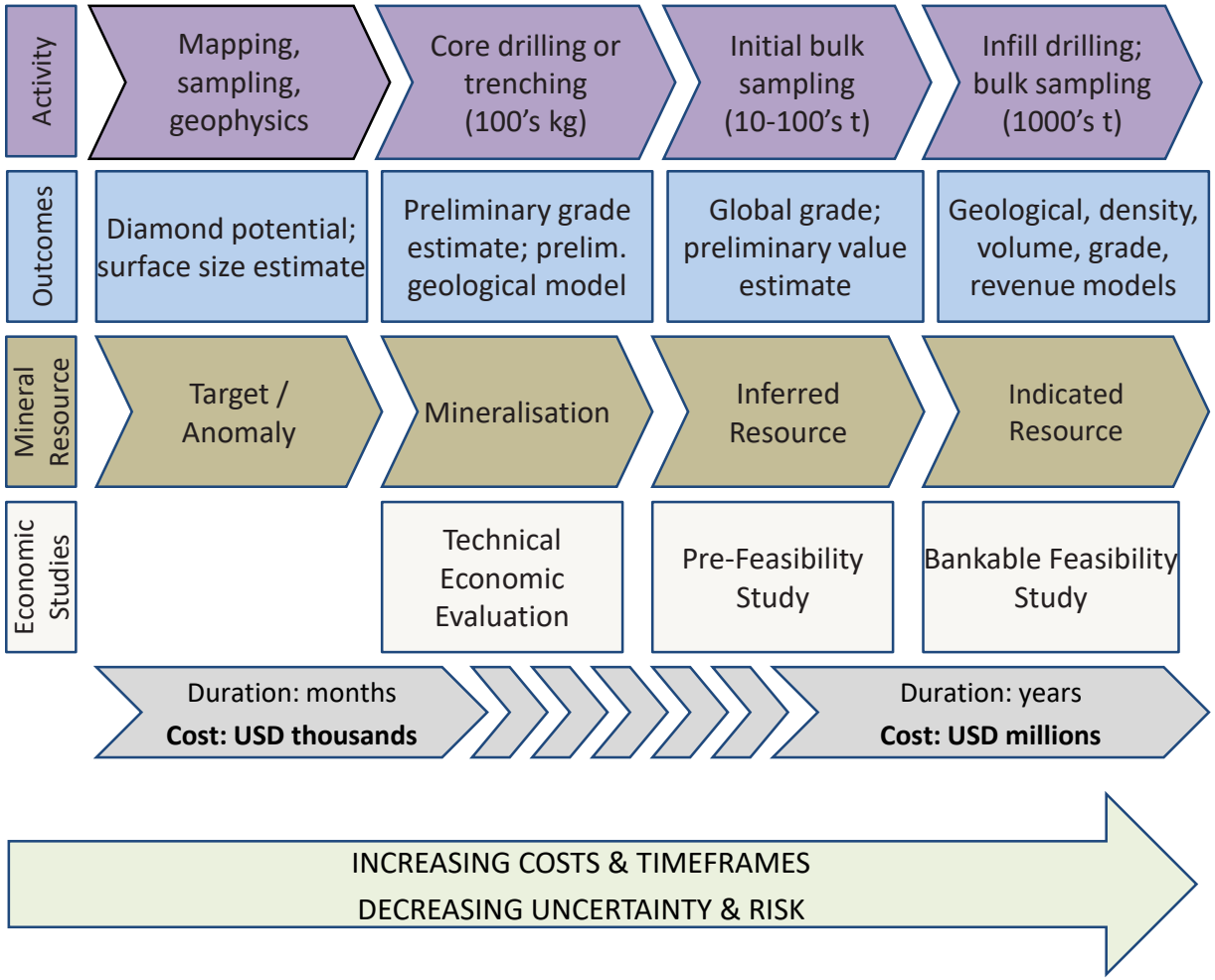
Risk management

The de-risking continuum



- Investors' appetite grows with confidence
- Costs increase exponentially
- Improving confidence is explorers burden
- Maximise optionality (phased approach)
- Extract value or cut losses early
- Technology, deep expertise
- Diamond breakage
- Large stone recoveries
- Material and newsworthy events

Assessing diamond potential for mining



- Confidence improves as new information is analysed and assumptions are revisited
- As confidence increases, so do costs and timeframes
- Accurate and reliable resource models are critical inputs to a sound economic assessment
- Technology plays a key role
- Expert operators are able to compress timeframes by synchronising workstreams without compromising on quality
- Deep knowledge, expertise are key differentiators

Regulatory requirements

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Reporting requirements are different

Stock Exchange	Mining-specific Reporting Requirements (post-listing)	Mineral Reporting Standard
ASX	Annual and half-year financial report Quarterly report by CP on production and development activities (incl. expenditure); exploration activities; mineral results & ore results	JORC
JSE	Annual and quarterly financial report Description of exploration and mining activities by CP; mineral resource and reserve statement	SAMREC
TSX/TSXV	Annual and quarterly financial report	CIM (NI 43-101)
LSE/AIM	Annual and half-year financial report Interim management statement Resource updates by CP (AIM)	JORC, SAMREC, CIM, other selected codes
HKEx/GEM	Annual and quarterly financial report Half-yearly updates on mining	JORC, SAMREC, CIM

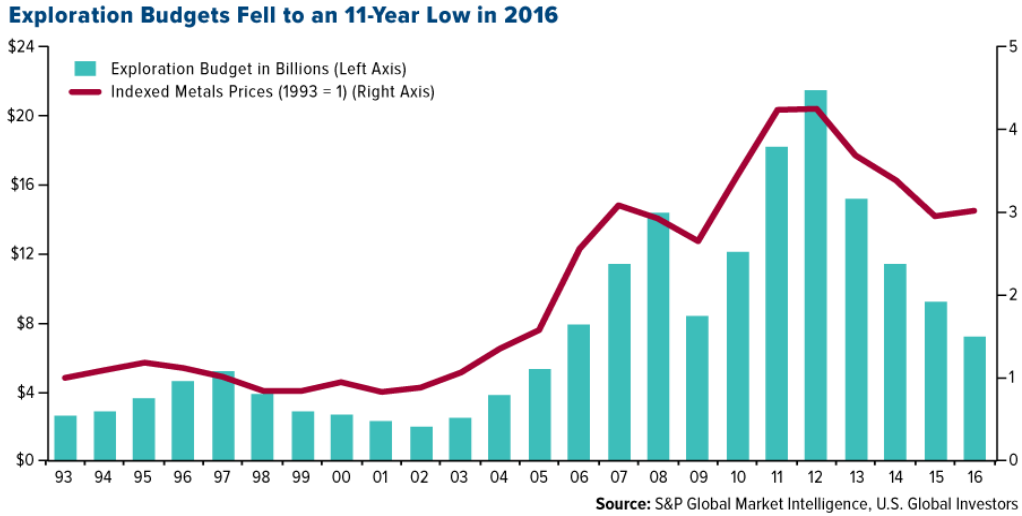
Source: PWC, Mining Association of Canada

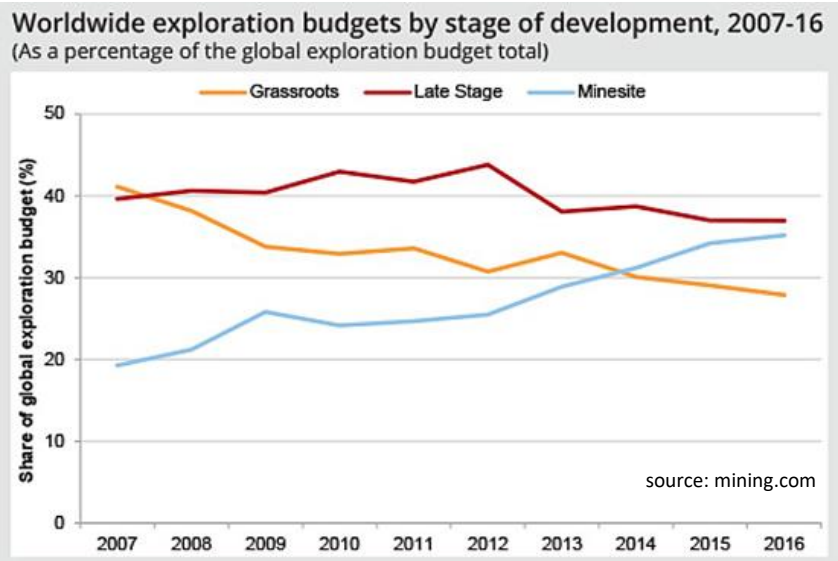
- Professional codes of practice set minimum standards for public reporting. Public reports must be prepared by a Competent Person ('CP')
- Majority of national reporting standards share a common set of codes and guidelines
- TSX, AIM and ASX host the bulk of junior and mid-tier exploration and development companies
- Reporting and regulatory requirements place a significant burden of compliance on juniors
- Relevance and transparency of reporting is increasingly important in attracting junior funding

Trends in exploration spend

Trends in exploration spend

Global exploration budgets 1993-2016 (all commodities)

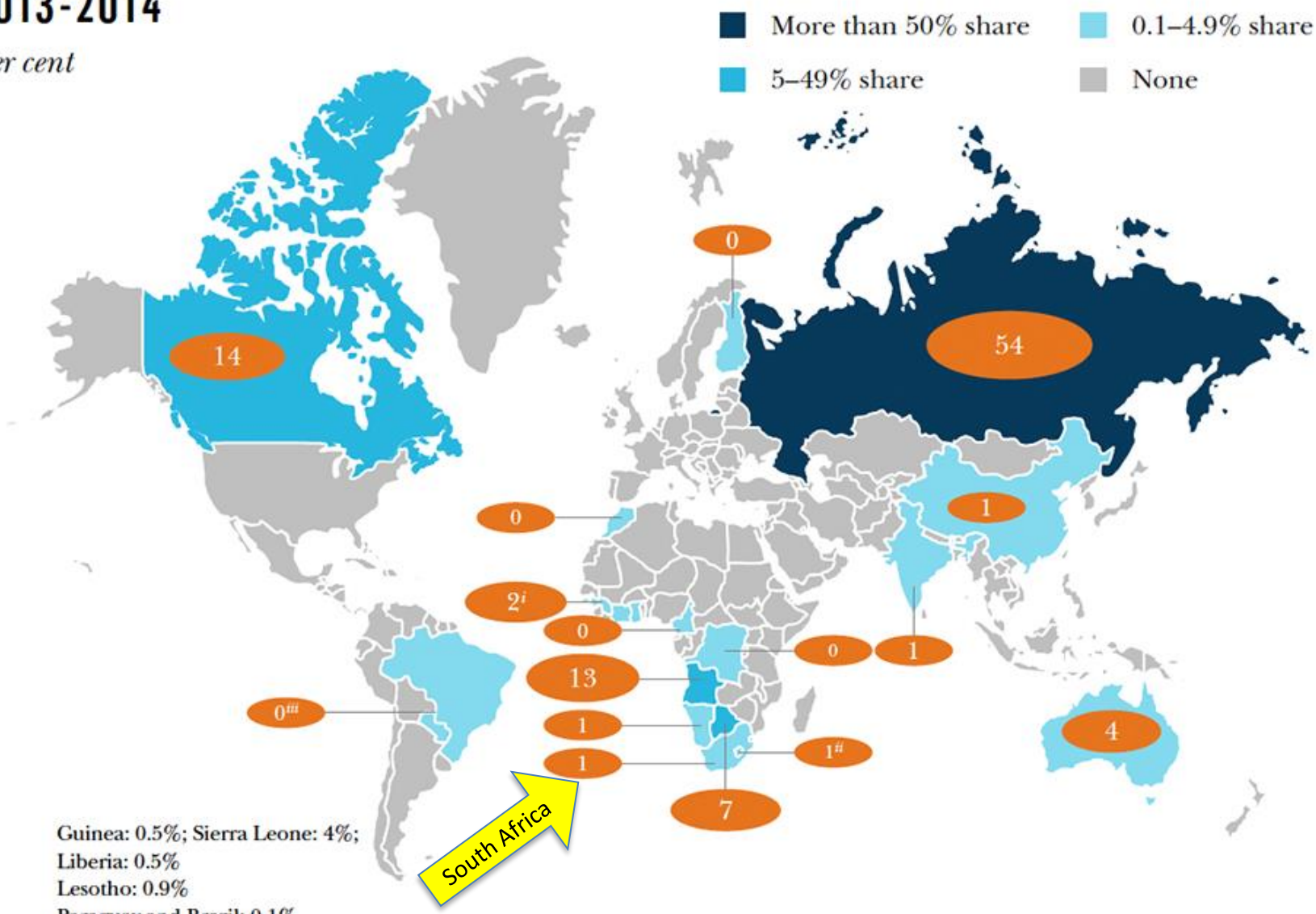




- Investment in exploration has been declining for a number of years, reaching a historic eleven-year low early in 2017
- Grassroots share of exploration budgets declining since the 1990's
- Late-stage and mine site exploration budget shares trending upward, reflecting short-term focus and risk aversion
- Majors driving exploration spend: late-stage regarded as less risky than grassroots
- Diamond exploration spend peaked around 2007-8
- Juniors' exploration spend constrained by tougher funding climate
- Lack of significant new diamond discoveries further curbing investors' appetite (vicious cycle)

SHARE OF GLOBAL DIAMOND EXPLORATION SPEND BY COUNTRY 2013-2014

Per cent



i Guinea: 0.5%; Sierra Leone: 4%; Liberia: 0.5%

ii Lesotho: 0.9%

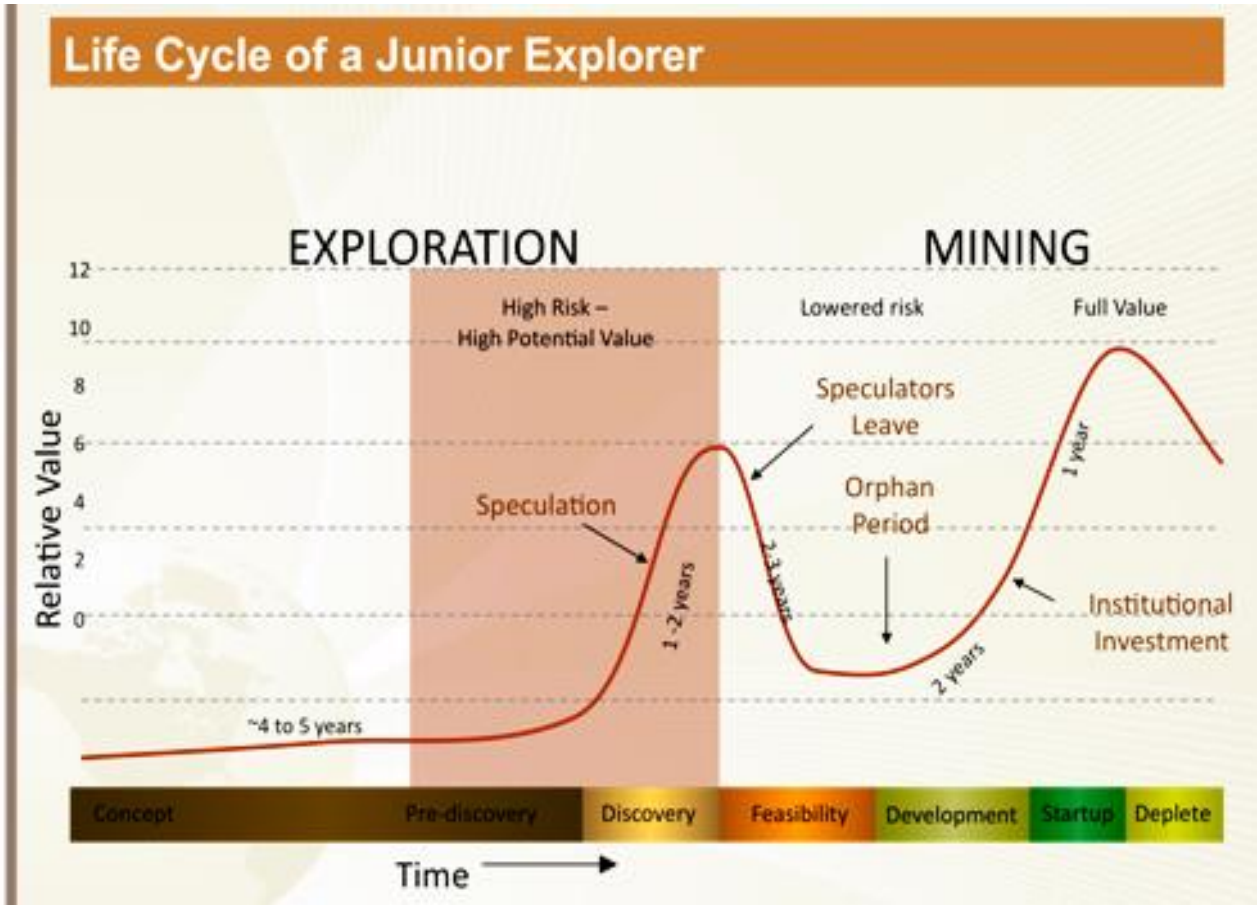
iii Paraguay and Brazil: 0.1%

Note: Total may not sum due to rounding

Source: De Beers estimates based on company publications and websites, SNL Metals & Mining's Corporate Exploration Strategies 2013; includes grassroots, late stage, and mine site exploration expenditures

Junior development funding

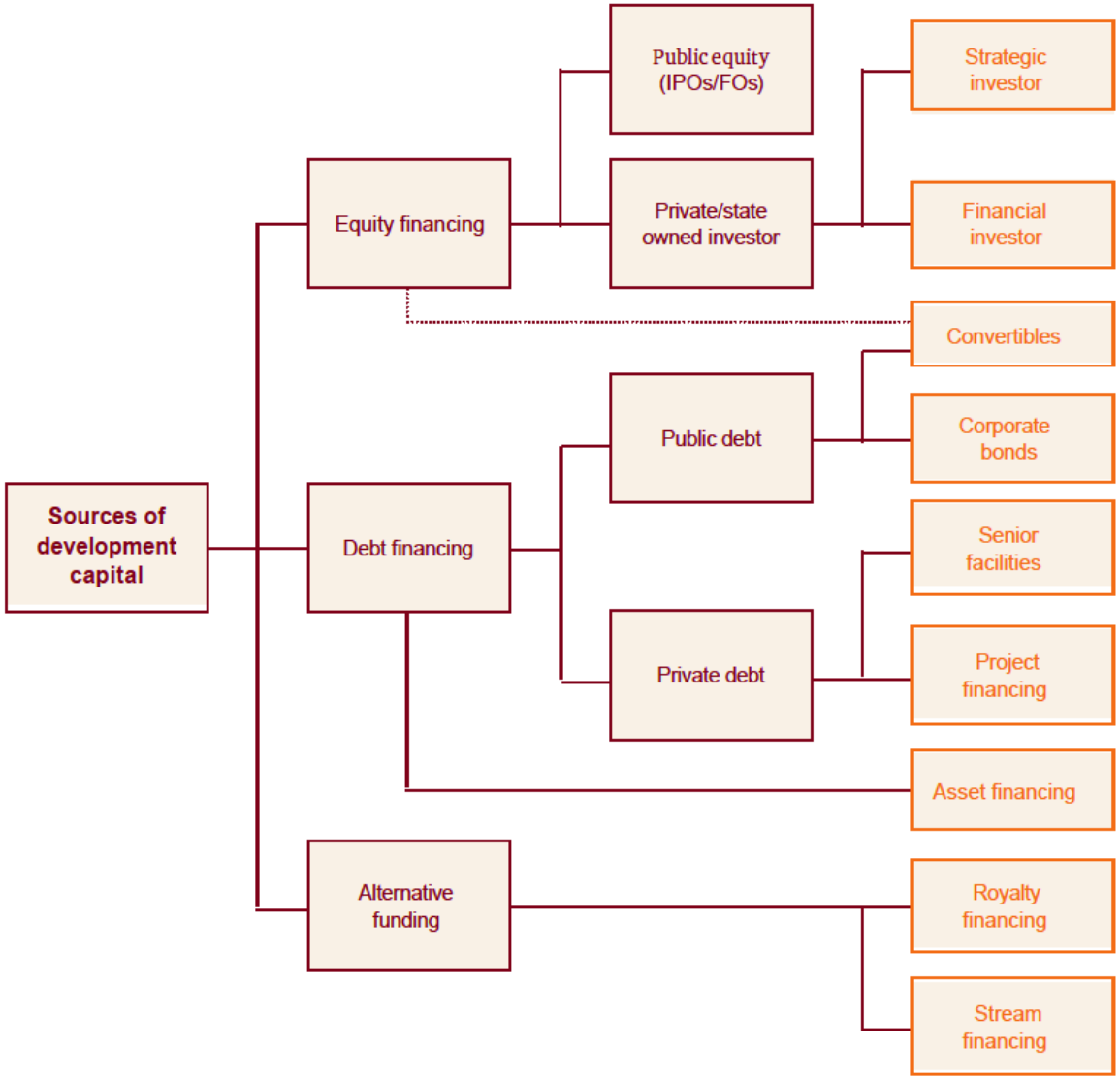
Junior exploration funding



source: Exploration Insights, 2016

- Discovery phase is high-risk, high-potential; early investors may see substantial gains
- During development phase, lack of news leads to sell-off by less patient investors
- Institutional investors begin to enter the scene at construction phase
- Navigating the 'orphan period' is a matter of survival for junior explorers
- And avoiding excessive dilution to the founding shareholders.
- Dire need for project incubators

Financing of diamond projects



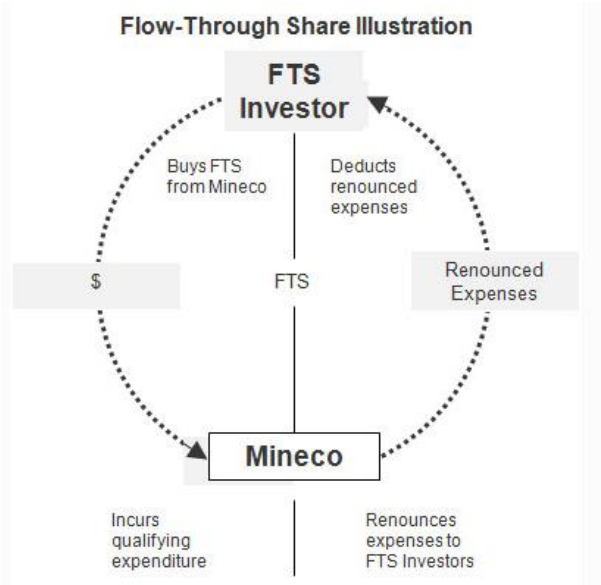
Modified after PwC, 2013

- Traditional equity and debt financing constrained by falling commodity prices and continued uncertainty
- Alternative funding sources better suited to junior and mid-tier miners, as they attract investors with higher risk appetite and faster decision-making than banks
- Alternatives often inaccessible to early stage 'greenfield' project developers

Tax-based financing incentives

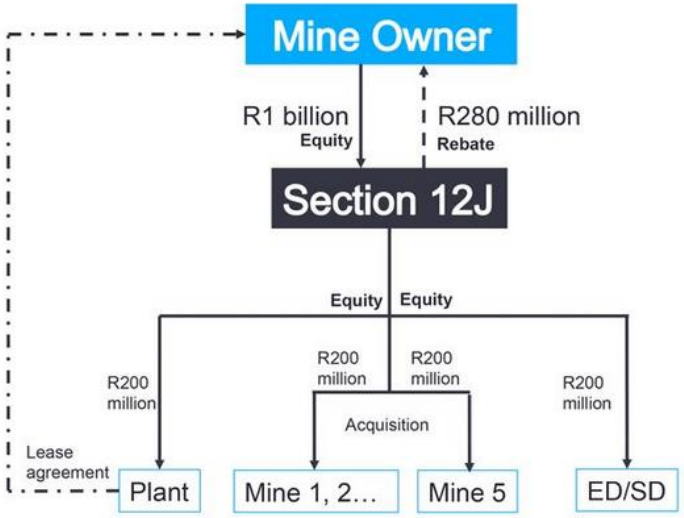
Canadian flow-through share (FTS)

- For over 25 years it has generated billions for mining exploration and contributed to the development of major mines, such as Ekati and Diavik.
- Designed to provide an incentive for financing qualifying exploration companies in Canada and shift the tax deduction from the explorers (who don't need it) to the purchasers of the FTS.
- Canadian mining firms have raised $2.5-billion in the past five years using this incentive.



South African Section 12J

- Introduced in 2009, amended in 2014.
- Investors acquire shares in an approved and registered venture capital company ('VCC') which, in turn, invests the funds in qualifying investee companies.
- The investee company must be unlisted or a junior mining company which may be listed on the Alternative Exchange Division (AltX) of the JSE Limited.
- Investments into the VCC may attract enterprise development or sustainable development points.
- Approximately 60 companies have registered.



Funders with expertise: mining incubators

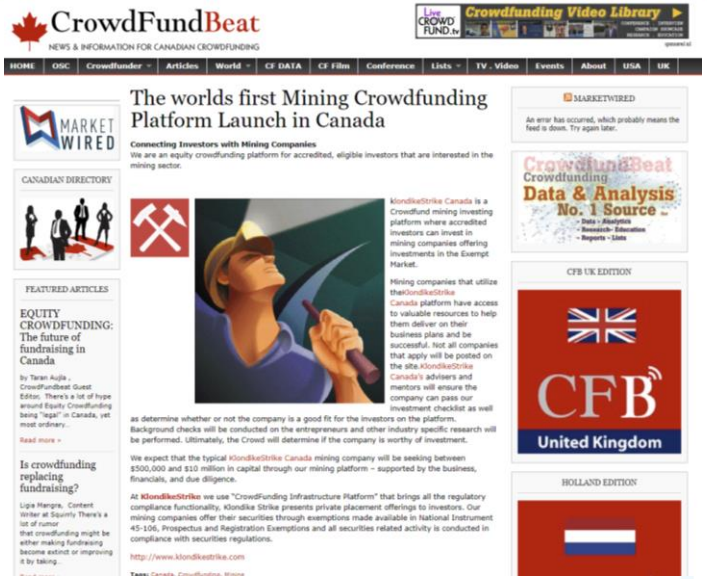
Companies such as the HDI (Hunter Dickinson Inc.), 162 Group and the Lundin Group have effectively applied a mix of entrepreneurial skills, business experience and risk appetite to identify viable opportunities for new ventures in the resources space.

Where are the new mining incubators?

Hunter Dickinson Inc.	Lundin Group	162 Group	Burgundy Diamonds
For over 30 years, HDI have successfully identified, acquired and developed mineral assets with high growth potential. Their portfolio has featured over 15 private and listed companies with projects around the world. HDI have raised more than CAD 1.9 billion in equity financing since 1985 and generated healthy returns on equity capital for shareholders.	Founded in 1971 by Adolf Lundin, the Lundin Group has raised billions of dollars to fund resource projects in the mining and oil/gas sectors. Progressive and true to its visionary founder's philosophy, today it comprises twelve listed companies operating in over twenty countries.	Focused on high potential natural resource start-ups, the 162 Group has negotiated over 30 joint ventures with multinationals and established 15 listed resources companies with interests across the globe, including AIM-listed Botswana Diamonds. The162 Group's core strategy is to identify opportunities, create the project, work with partners and develop.	A new entity focussed on the diamond exploration sector, Burgundy Diamonds seeks to establish itself as a niche project incubator operating within the "gap" between Juniors and Majors, providing risk funding and project development in partnership with owners of diamond projects.

Emerging alternatives: crowdfunding?

- CSEF, or Crowd Sourced Equity Funding, enables project owners to raise funds through secured online platforms from a large number of small investors who can own equity in emerging mining companies for as little as $500.
- Dedicated crowdfunding platforms for mining companies have been launched in Canada and Australia and others are in development in the UK
- Regulators in Canada and the US have already adopted rules allowing the sale and purchase of securities via crowdfunding portals. Lobbying is ongoing in Australia to change the legislation in support of crowdfunding
- The viability of crowdfunding platforms in the diamond exploration space remains to be ascertained.



Discussion & Conclusions

Discussion

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- Where and how can juniors attract early investment and source sufficient funding to navigate the 'orphan period'?
- Could crowdfunding in mining become a viable option for juniors seeking exploration seed funding?
- The South African government has identified small business incubators as a priority, but how will they be financed?
- Will the incentive structure introduced by Section 12J of the Income Tax Act be sufficient?
- Why are many juniors active in South Africa not listed on AltX?
- Could those firms operating as JSE/AltX sponsors enhance their offering through business incubator services to potential new entrants? Do they have skills and access to capital?

Conclusions

- Diamond exploration and resource development is a highly complex business with a high failure rate.
- Exploration expenditure has been slashed.
- Diamond demand grows.
- Supply is diminishing.
- Junior diamond explorers' still struggle to access exploration and early stage project funding.
- It is probably harder to raise money now than it was 10-years ago.
- Entrepreneurs with a following and isolated 'junior incubators' have been instrumental to the growth of certain diamond companies. Why are there not more?

<u>If an AK6 was discovered today, would it have a different story?</u>

About the Author

- James Campbell is Managing Director of Botswana Diamonds plc and has spent over thirty years in the diamond industry. He is also a Non Executive Director of Shefa Yamim ATM (a precious stones explorer in Israel, listed on the LSE).
- Previous roles include Chief Executive Officer and President of Rockwell Diamonds Inc, Non Executive Director of Stellar Diamonds plc, Vice President - New Business for Lucara Diamond Corp, Managing Director of African Diamonds plc, Executive Deputy Chairman of West African Diamonds plc.
- James worked at De Beers for over twenty years; his roles included General Manager for Advanced Exploration & Resource Delivery and Nicky Oppenheimer's Personal Assistant.
- James holds a degree in Mining & Exploration Geology from the Royal School of Mines (Imperial College, London University) and an MBA with distinction from Durham University. He is a Fellow of the Institute of Mining, Metallurgy & Materials, South African Institute of Mining & Metallurgy and Institute of Directors of South Africa. He is also a Chartered Engineer (UK), Chartered Scientist (UK) and a Professional Natural Scientist (RSA).
- James is deeply committed to South Africa and is also chairman of the Joburg Ballet (Africa's largest and most successful ballet company) and Common Purpose SA (a not-for-profit organization that develops leaders who can cross boundaries and is synonymous with the terms 'cultural intelligence' and 'leadership beyond authority'.).

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