

30 January 2008

# African Diamonds

Price: 80.5p

## Upcoming Events:

Bots. Gov share AK6 decision (2008)  
 AK8 bulk-sample results (1Q08)  
 Boteti Technical Review (1Q08)  
 Financial year end (June 2008)

Market cap	£61.3m
Ticker	AFD LN
Price Target (p)	n/a
EV / in-situ value	27.9%
EV / O8E revenue	n/a
Cash in hand (£m)	3.5

52 week (p)	
High	100.1
Low	80.5

3M-avg. daily vol. (000s)	76.2
3M-avg. daily val. (£000)	79.1

Shares	
Basic	76.2m
Fully diluted	79.1m

Top shareholders	
JP Morgan	9.9%
De Beers	5.8%
Black Rock	5.7%
WB nominees	5.5%
Total	26.9%

## Share Price Performance (p)



Source: Fidesa

## Analyst

Brock Salier  
 Metals & Mining  
 +44 (0)207 776 6402  
 brock.salier@ambrian.com

## Main Assets

Project	Ct (m)	Grade (cpht)	US\$/ct	US\$/t	Interest	Stage
AK6, Botswana	11.1	22	131	28.8	28.38%	Development
AK8, Botswana	-	-	-	-	70%*	Exploration
Boteti JV, Botswana	-	-	-	-	30%	Exploration
West Africa Diamonds, AIM	-	-	-	-	12.5%	Expl'n + Dev.
Bugeco - DRC	-	-	-	-	35.4%	Exploration

\*Assuming African Diamonds operate; Source: Company data, JORC/43-101 resources only

## Company Description

**Focus and Strategy:** African Diamonds is focused on bringing its 28.4%-owned AK6 project into production by late-2009. The pipe is the most advanced of a suite of kimberlite evaluation projects being undertaken in JV with De Beers in Botswana. So far over 500 holes and 50km of drilling have been completed within the JV.

After the spin-out of West African assets in 2007 into AIM-listed West African Diamonds, management is now focused on Botswana. However, connections are still maintained with both the DRC and West Africa through minority interests in exploration ventures in those countries.

AK6 is progressing towards production, which is currently scheduled for 4Q09. The indicated resource is 11.1Mcts at an average grade of 22cpht and value of US\$131/ct, although this will likely increase marginally in grade, but significantly in carat value as drilling continues post mining license application. In addition to evaluation of known kimberlite pipes in Botswana, African Diamonds has a large 100%-owned landholding on which it is carrying out grassroots exploration.

African Diamonds' share price fell from around £1.10 to 70p in 4Q07 as development continued. At this time Firestone Diamonds sold its 7.3% for £4.9m, although this was in a single trade.

**Management:** African Diamonds owes much of its success to the dynamic influence of Executive Chairman John Teeling. John has over 30 years' experience, and an MBA from Wharton and PhD in Business Administration from Harvard. He is founder and chairman of Pan Andean Resources, Petrel Resources and Persian Gold, and a former director of Kenmare Resources and Arcon. Managing Director James Campbell adds operational strength, having worked for De Beers for over 20 years, cumulating as General Manager responsible for resource delivery in the global mining and exploration group. James has experience in both geology and management, having worked on small-scale mine development and was the personal assistant to Nicky Oppenheimer.

## Project Summary

Project	Equity	Comment
<b>DEVELOPMENT</b>		
AK6 - Botswana	28.38%	JV with De Beers to bring kimberlite into production by 4Q09
<b>EXPLORATION</b>		
AK8 - Botswana	70%	Advanced evaluation kimberlite, bulk-sample results pending
Boteti JV	30-70%	Evaluation of numerous kimberlites, including six at mini bulk-sampling stage
Botswana exploration	100%	Large landholding of non-JV land on which grass roots exploration underway
<b>OTHER</b>		
W. Af. Diamonds - Sierra Leone, Guinea	12.5%	Alluvial and tailings projects to fund kimberlite exploration, AIM listed
Bugeco - DRC	35.4%	Private company in DRC exploring for kimberlites in JV with De Beers

Source: Company reports

**Boteti JV (30-70%)** is an exploration JV over 3,966km<sup>2</sup> in three main areas: Orapa (1,320km<sup>2</sup> around the mine), Serowe (2,482km<sup>2</sup>) and Shashe (163km<sup>2</sup>) in eastern Botswana. De Beers funds exploration until BFS, after which each company pays its own way. Under the agreement African Diamonds will operate, and receive 70% of gross profit, from mines with <US\$70m annual revenue. AK6 is an example of an asset with over US\$70m revenue, whereas AK8, if economic, could be operated by African Diamonds given the lower grades. All diamond sales from any mines must be through the Diamond Trading Company.

Key assets are AK6 (proceeding to mine), AK8 (bulk-sampling), four kimberlites at mini bulk-sampling stage (BK3, BK6, BK7, AK9), and 15 kimberlite pipes undergoing reassessment. Through the course of 2007 two kimberlites returned disappointing bulk-sample results – AK10 and BK13.

From a grassroots perspective, De Beers is involved in active exploration on the licences, with a new geophysical technique (SQUID) being used to look for kimberlites to the north of Orapa, where deep sands have previously slowed exploration. However, most of the focus on the licences is on evaluation of known kimberlites.

**AK6 (28.4%)** is the flagship project for African Diamonds. Re-sampling and re-interpretation of the geometry led to significant grade and size increases, and it is now in the process of development in a joint venture with De Beers.

A mining lease application was submitted in 3Q07, and is expected to be granted in 1Q08. The mine will operate at a phased rate of 2.7Mtpa from 4Q09, ramping up to 4.2Mtpa in 2011-12 with additional capital requirements. Capital for the first phase is estimated at US\$220m including contingency, while operating costs should be around US\$8/t. With a BFS completed in late-2007, the company expects to be in production in 4Q09.

African Diamonds is required to contribute capital on a pro-rata basis, with 75% to come from project finance and 25% from debt, provided by De Beers at Libor +3%. The Botswana Government has the right to take up as much as 50% of the project, although it is unclear at this stage if this will occur, with 0-20% a likely range of equity share.

A key figure for the AK6 project is the resource size. The current resource is estimated at 51.8Mt with an average value of US\$131/ct and grade of

22cpht. However, high-value and difficult to detect (non-fluorescent) 'Type II' diamonds have been identified in the pipe, and it is thought that the grade could be as high as 30cpht with values up to US\$200/ct. The current resource size is for kimberlite to 400m depth, although this is likely to increase with internal estimates of 22.3Mt between 400-756m depth.

Of note, the mining licence application contains economic models, so in effect African Diamonds is in a moratorium period where it cannot publish major changes to resources, grades, values, etc.

**AK8 (70%)** is 10km from AK6, and is a 5ha pipe currently undergoing resource estimation. The pipe contains a modelled 15Mt to 300m depth, with an average grade of 4-9cpht and diamonds priced at US\$60/ct. Three LDD holes were drilled in 2007, with results expected in 1Q08.

**Kedia (100%)** comprises licences over 1,984km<sup>2</sup> 120km west of Orapa, granted to African Diamonds in late-2007. The area contains diamond indicator minerals which are interpreted to be unrelated to both the Gope and Orapa fields, but no primary source has ever been identified.

**Mmashoro (100%)** covers an area of 981km<sup>2</sup>, although 53% of this is in the process of being relinquished. Sands up to 40m deep cover much of the area, hampering exploration. Exploration is ongoing after 2007 drilling of geophysical targets intersected dolerite not kimberlite.

**Bugeco (35.4%)** is a private Belgian company targeting diamonds in DRC. Management is credited with the discovery of the Morila gold deposit in Mali, and has ties with Anglo American. De Beers has a 70% option over around 9,000km<sup>2</sup> of licences, and carries out all exploration. Ten kimberlites have been discovered in two clusters over the last four years. Geophysics is now complete, and the 2008 focus is on ground sampling and discovery drilling.

**West African Diamonds (12.5%)** was spun out of African Diamonds in 2007. The company is a junior (£10m market cap) with a suite of alluvial and tailings gold-diamond near-production projects and development projects funding kimberlite and alluvial diamond exploration. Assets are in Sierra Leone and Guinea.

Resource and Reserve - AK6 project					
Category	Tonnes (Mt)	Grade (Cpht)	Carats (m)	US\$/ct	US\$/t
Indicated	51.8	22	11.1	131	28.8
<b>Total</b>	<b>51.8</b>	<b>22</b>	<b>11.1</b>	<b>131</b>	<b>28.8</b>

Source: Company reports, December 2007

## Opinion

African Diamonds has many similarities with Firestone Diamonds in terms of holding a portfolio of kimberlite pipes in Botswana. The clear advantage is the now-proven economic viability of AK6. Once in production, this mine should transform African Diamonds from a tight-budgeted exploration company to a well-funded miner able to carry out aggressive exploration.

Despite the apparent success of AK6, there are two key unanswered questions in its development – the share of the project that the Botswana Government intends to take, and the final grade and carat

value. While management is hoping for higher grades and carat value through recovery of Type II diamonds and thorough bulk-sampling, the most recent round of bulk-sampling doesn't support this (mid-2007). As such, more work is now required to clarify the likely production metrics of the operation. As to the Botswana Government's share, experts we've spoken to put forward cases in both directions, ie, of course the government will take 50%, it's what the law was designed for, or alternatively, no the government won't take 50% in order to encourage further exploration, as exemplified by the (much smaller) Lerala mine being commissioned by Diamonex (ASX/AIM DON).

Importantly for investors, once the mining licence negotiations are completed, African Diamonds will be free to publish resources upgrades, which we expect it will.

Our DCF calculation for AK6 values the asset at 70-120p on an undiluted basis depending if grade lifts above the current 22cpht and the diamond value lifts above US\$130/ct. However, should the Botswana Government take up its option for a 50% share, this obviously falls, although this will be offset by the purchase price.

## Investment Case and Recommendation

**Investment Case:** Any investment in AK6 will ultimately be based on the hope that (a) the resource size, grade and value increases at AK6, (b) the Botswana government doesn't take up its share in AK6 thus diluting De Beers and African Diamonds, and, of course (c) exploration success.

In the medium term, potential investors are looking at, as is usual for diamond companies, a high-risk, high-reward proposition for diamond exploration. With active and advanced sampling on four remaining kimberlites (two dropped in 2007 following disappointing results), near-term upside is focused on the Boteti JV. In 2010, once AK6 is in full swing, we would expect a multiple of NPV to be ascribed to the project, which should offer some uplift.

The company is certainly keeping its finger on the pulse of other African countries, with minority interests in various ventures, but has yet to put its cards on the table with a full equity share of any of these.

**Recommendation:** This is a well managed company with at least one world-class asset. Relative to the market, African Diamonds is highly rated and we believe the price fully reflects this. We value the AK6 project in the 80-120p price range, leaving the best-case near-term upside ranging from a worrying 15% (if Botswana government buys in) to 70% share in kimberlite exploration JVs with De Beers.

In our view, we think the share price will lift in reaction to resource estimates released after the mining licence is granted, making this an attractive investment over a six-month horizon. Beyond this, we would hold off on an investment until positive bulk-sampling results are returned from Botswana (not mini bulk-sampling), the company steps up exploration on its 100%-owned tenements in Botswana, or makes a play outside Botswana.

## Research

Kam Bansil	+44 (0)20 7776 6475
Richard Chase	+44 (0)20 7776 6461
Julian Emery	+44 (0)20 7776 6476
Richard Lucas	+44 (0)20 7776 6467
Brock Salier	+44 (0)20 7776 6402
Dougie Youngson	+44 (0)20 7776 6472

## Sales

Charles Bendon	+44 (0)20 7776 6469
Forbes Cutler	+44 (0)20 7776 6473
Anthony Nathan	+44 (0)20 7776 6463
David Pettman	+44 (0)20 7776 6479
Mike Read	+44 (0)20 7776 6459

## Trading

Lee Hunter	+44 (0)20 7776 6458
Darren Knight	+44 (0)20 7776 6468
David Mackay	+44 (0)20 7776 6478
Nick Screech	+44 (0)20 7776 6498
Chris Stallard	+44 (0)20 7776 6496

## Operations

Mike Dack	+44 (0)20 7776 6464
Alison Pride	+44 (0)20 7776 6462

---

## Company Address

Ambrian Partners Limited  
2<sup>nd</sup> Floor  
8 Angel Court  
London  
EC2R 7HP

Telephone	+44 (0)20 7776 6400
Website	<a href="http://www.ambrian.com">www.ambrian.com</a>
Emails	<a href="mailto:firstname.lastname@ambrian.com">firstname.lastname@ambrian.com</a>

---

Ambrian Partners Limited is authorised and regulated by the Financial Services Authority for the conduct of Investment Business in the UK and is a Member of the London Stock Exchange.

Ambrian Partners Limited is registered in England and Wales no. 4236075. Registered office - 8 Angel Court, London EC2R 7HP. Phone +44 (0)20 7776 6400 Fax: +44 (0)20 7776 6470 Email: [research@ambrian.com](mailto:research@ambrian.com)

For the purposes of the FSA's requirements in relation to the management of Conflicts of Interest, this publication is categorized as a financial promotion. Please refer to the Compliance Department for a summary of our conflicts of Interest Policy and Procedures.

The information and opinions in this report were prepared by Ambrian Partners Limited "Ambrian". It has been approved for publication and distribution in the UK by Ambrian which is regulated by the Financial Services Authority (FSA) for the conduct of Investment Business in the UK and is a member of the London Stock Exchange.

The information and opinions contained herein have been obtained from public sources and are believed by Ambrian to be reliable, but we make no representation as to the accuracy or completeness of such information.

The analyst principally responsible for the preparation of this report receives compensation that is based upon, among other factors, Ambrian's overall investment banking revenue. However, such analysts have not received, and will not receive, compensation that is directly based upon one or more specific investment banking activities or transactions.

Opinions, estimates and projections in this report constitute the current judgement of the author as of the date of this report. They do not necessarily reflect the opinions of Ambrian and are subject to change without notice. Ambrian has no obligation to update, modify or amend this report or to otherwise notify the reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate, or if research on the subject company is withdrawn. Prices and availability of financial instruments are also subject to change without notice. This report is provided for informational purposes only. It is not to be construed as an offer to buy or sell or a solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy in any jurisdiction.

Ambrian may engage in securities transactions in a manner inconsistent with this report, and with respect to the securities covered by this report, may buy from and sell to customers on either an agency, a principal investment, or market making basis. Disclosures of conflicts of interest, if any, are disclosed at the beginning of this report, or are available from the Compliance Officer. On the date of this report Ambrian, persons connected with it and their respective directors may have a long or short position in any of the investments mentioned in this report and may purchase and/or sell the investments at any time in the open market as an agent. Additionally, Ambrian within the previous twelve months may have acted as an investment banker or may have provided significant advice or investment services to the companies or in relation to the investment(s) mentioned in this report.

When we comment on AIM and Plus Market listed shares, customers should be aware that because the rules for these markets are less demanding than for those of the Official List of the London Stock Exchange the risks are higher.

The report is confidential and is submitted to selected recipients only. It may not be reproduced in whole or in part to any other person. Ambrian and /or persons connected with it may effect or have effected transactions in the investments referred to in the material contained in this report.

This report is prepared for professional clients and is not intended for retail clients in the UK as defined by the FSA rules and should not be passed on to such persons. Any U.S. person receiving this report and wishing to effect a transaction in any security discussed herein, must do so through a U.S. registered broker dealer.