



LUCARA

DIAMOND

Management's Discussion and Analysis
And
Consolidated Financial Statements
Year Ended December 31, 2018

LUCARA DIAMOND CORP.
ANNUAL MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2018

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, 2018, which are prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). All amounts are expressed in U.S. dollars unless otherwise indicated.

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

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

The effective date of this MD&A is February 21, 2019.

ABOUT LUCARA

Lucara is a leading independent producer of large exceptional quality Type IIa diamonds from its 100% owned Karowe Diamond Mine in Botswana. The Karowe Diamond Mine has been in production since 2012 and is the focus of the Company's operations, development and exploration activities. In February 2018, the Company acquired Clara Diamond Solutions Corp. ("Clara"). Clara, now a wholly-owned subsidiary of Lucara, has developed a secure, digital sales platform that uses proprietary analytics together with cloud and blockchain technologies to modernize the existing diamond supply chain, driving efficiencies, unlocking value and ensuring diamond provenance from mine to finger. Lucara has an experienced board and management team with extensive diamond development and operations expertise. Lucara and its subsidiaries operate transparently and in accordance with international best practices in the areas of sustainability, health and safety, environment and community relations.

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

HIGHLIGHTS

- The Karowe Diamond Mine achieved a strong operational performance in 2018, meeting or exceeding guidance in all areas:
 - Total tonnes mined of 18.1 million (guidance: 15.5 million to 18.7 million)
 - Ore and waste mined was 3.1 million tonnes and 15.0 million tonnes respectively
 - Ore processed totaled 2.6 million tonnes (guidance: 2.4 million to 2.7 million tonnes)
 - 366,086 total carats recovered (revised guidance: 325,000 to 350,000 carats)
 - No lost-time injuries
- 2018 was a record year for the recovery of Specials (single diamonds in excess of 10.8 carats) with 829 stones totaling 24,793 carats recovered, including 33 diamonds in excess of 100 carats, of which 5 stones were in excess of 300 carats.

- Total revenue of \$176.2 million (2017: \$220.8 million) or \$502 per carat (2017: \$847 per carat) was recognized during fiscal year 2018 (revised guidance: \$180 million to \$190 million). 2017 revenues included the sale of the historic 1,109 carat Lesedi La Rona ("LLR") which sold for \$53.0 million (\$47,777 per carat). Excluding the LLR, revenue in 2017 was \$167.8 million with an average sales price of \$647 per carat. The average sales price per carat in 2018 was impacted by a higher recovery of finer diamonds, although recovery of Specials was at a record level. The Company has also been building inventory for Clara that will be made available for sale through the ramp up period, based on demand, estimated to have a realized value of approximately \$2.3 million.
- The operating cash cost for the year ended December 31, 2018 was \$40.93 per tonne processed (2017: \$34.56 per tonne processed) compared to the full year forecast cash cost of \$38-\$42 per tonne processed (see page 12 Non-IFRS measures). Operating cash cost per tonne processed was impacted by higher than expected tonnes mined and an increase in the cost per tonne mined due to the mining contractor transition which commenced mid-2018. Operating cash cost guidance was met for the year inclusive of the unplanned change in the mining contractor. The second half of 2018 saw a smooth transition between mining contractors and a return to strong production, recovering the ground lost in mining waste in the first half of 2018. Operating cash costs for 2019 are anticipated to be lower at \$32-37 per tonne processed after a significant portion of waste stripping was completed in 2018.
- Clara completed its inaugural sale in Q4 2018 with total sales of \$660,865, achieving a premium margin over traditional sales tenders and demonstrated the value that can be unlocked using this new approach. Development activities were completed under budget at \$1.8 million.
- Adjusted EBITDA for the year ended December 31, 2018 was \$60.5 million as compared to adjusted EBITDA for the same period in 2017 of \$113.5 million, which included the sale of the LLR (see page 12 Non-IFRS measures).
- Net income for the year ended December 31, 2018 was \$11.7 million (\$0.03 per share) as compared to net income of \$65.1 million (\$0.17 per share) in 2017.
- As at December 31, 2018, the Company had cash and cash equivalents of \$24.4 million, including \$10 million provided by the Company's working capital facility. In 2018, the Company invested \$60.7 million in the business, primarily towards the completion of a major waste stripping campaign (Cut 2) in support of open pit mining to 2025, the underground feasibility study, which aims to extend mine-life to at least 2036, and, improvements to plant and equipment to maximize carat recoveries. \$40 million of the Company's credit facility remains undrawn on December 31, 2018.
- The Company paid a quarterly dividend of CA\$0.025 per share on December 20, 2018 for a cumulative dividend of CA\$0.10 per share in 2018, totaling \$30.3 million (2017: \$29.4 million) returned to shareholders. Since inception in June 2014, the Company has paid dividends of \$249 million (CA\$319 million).

KAROWE DIAMOND SALES

Diamonds are heterogeneous by nature, with thousands of different price points depending on weight, colour, shape, and quality. Diamond production from Karowe is characterised by a coarse diamond size frequency distribution and is positively impacted by the regular recovery of diamonds in excess of 10.8 carats in size, referred to as "Specials." Karowe production is further distinguished by the consistent recovery of high value, gem quality Specials.

Specials are reported by total stone count and as a percentage of the total production. In 2018, a total of 829 stones were recovered representing 6.8 weight percent of total carats, the largest carat tally for Specials in Karowe's history and consistent with the Resource Model for Karowe. Overall production in 2018 was positively impacted by the processing of South Lobe ore and the contribution of EM/PK(S) material within the South Lobe.

Specials are sold as single stones (high value diamonds), in baskets of +10.8 carat goods (of similar quality and weight), or in parcels of mixed poorer quality goods. Diamond prices are driven by: weight, colour, quality (cracks and inclusions) and shape (yield). While 2018 was a record year for the number of Specials recovered, the overall average price for Specials sold in 2018 was lower than in previous years due to the quality of some of the larger Specials recovered. Sales of individual stones at prices between \$2 million and \$5 million were consistent with previous years. However, in 2018 no individual stones were sold at prices between \$5 million and \$10 million (as compared to 1 to 3 stones each year between 2015 and 2017) and only one stone sold for more than \$10 million. This variability is not unprecedented, given the nature of the Karowe orebody where, on average, single stone sales account for between 60% and 70% of total annual revenue. Lucara remains very confident that high quality, large stone recoveries will continue throughout the mine life. To date in 2019 alone, two top white gem diamonds (240 and 127 carats) and one high white gem diamond (223 carats) have been recovered, indicating a strong start to the year.

Table 1: Historical Sales Data for Single Stones in Excess of +10.8 carats*:

Summary	2015	2016	2017	2018
< 50 cts	90	41	70	93
> 50 cts.	32	39	29	37
> 100 cts.	15	21	10	13
> 200 cts.	7	7	4	6
> 300 cts.	2	2	2	4
Single Stones > 10.8 cts.	146	110	115	153

* Tabulated Specials that are sold as single stones (high value diamonds) will not sum to total Specials recovered since Specials are also sold in baskets of +10.8 carat goods (of similar quality and weight), in parcels of mixed, poorer quality goods, or in certain cases diamonds were not sold in the year in which they were recovered.

Certain stones from the Karowe production and other aggregated diamonds were offered for sale through the Clara platform for the first time in Q4 2018. As we move into 2019, the Company will be optimizing its sales process through the use of tenders as well as offering stones for sale through Clara.

FINANCIAL HIGHLIGHTS

Table 2: <i>In millions of U.S. dollars, except carats or otherwise noted</i>	Three months ended December 31		Year ended December 31	
	2018	2017	2018	2017
Revenues	\$ 40.6	\$ 37.1	\$ 176.2	\$ 220.8**
Net (loss) income for the period	(6.2)	1.7	11.7	65.1
Earnings per share (basic and diluted)	(0.02)	0.00	0.03	0.17
Cash on hand	24.4	61.1	24.4	61.1
Average price per carat sold (\$/carat)*	367	535	502	847**
Operating expenses per carat sold (\$/carat)*	233	255	216	238
Operating margin per carat sold (\$/carat)*	134	280	286	609**
Carats sold	110,553	69,358	350,798	260,526

(*) Average price per carat sold, operating expenses per carat sold and operating margin per carat sold are Non-IFRS measures, see table 5: Results of Operations for reconciliations and page 12 for Non-IFRS measures.

(**) Includes the sale of the LLR during 2017 for \$53 million (\$47,777 per carat). Adjusting for the sale of the LLR, revenues were \$167.8 million, the 2017 average price per carat sold was \$647, and the operating margin per carat sold was \$408.

The Company achieved revenues of \$40.6 million or \$367 per carat for its sales in the fourth quarter, yielding an operating margin of 36% during the period. The second half of 2018 saw Lucara host its first blended tender process in which both regular and exceptional diamonds were made available for sale.

Diamonds recovered between September and November 2018 were sold in the fourth quarter tender in December achieving an average price per carat of \$367 from the sale of 110,553 carats (Q4 2017: \$535 from the sale of 69,358 carats), a 59% increase in the number of carats sold as compared to the same quarter last year.

Overall the higher revenues in the quarter reflect an increase in the number of carats sold in the fourth quarter over last year, but the average price per carat sold is lower than Q4 2017 due to the higher volume of smaller diamonds sold and lower quality Specials. Lower revenues per carat reflect natural variability in the number and quality of exceptional diamonds sold in any quarter. The increase in the number of carats available for sale in the December tender follows commissioning of the sub-middles circuit in Q3 2017 and increased efficiency in diamond recovery in the smaller sizes during 2018. The number of carats recovered in Q4 2018 (81,850 carats) was 27% more than the number of carats recovered in Q4 2017 (64,477 carats). As the number of carats increases from better recovery in the smaller, lower value sizes, the average sales price per carat is reduced accordingly.

In Q3 2018, Lucara began setting aside diamonds in the one to four carat size range in the better colours and qualities, for sale on Clara, Lucara's secure digital rough diamond sales platform. The inaugural trial on Clara was completed in mid-December 2018 with diamonds successfully matched to orders generating sales proceeds of \$660,865, achieving +8% over Lucara's market price and +15% over Lucara's reserve price for these goods. Proceeds from the first sale were recorded to development costs as pre-production revenue. The first sale on Clara demonstrated that the platform works as intended and further confirms that it is now ready and has the capacity to on-board additional manufacturers in the short term. Further, Clara continues to receive expressions of interest from both manufacturers and producers alike, and growth in both volume of orders and supply is expected over the coming months as the platform moves into continuous sales. A second sale on the platform was completed in early February and a third sale is planned for March. Thereafter, a steady ramp up in sales through Clara is anticipated in 2019. Lucara will be reporting sales through Clara quarterly, along with additional guidance, once the platform has moved into continuous sales. Lucara will continue to optimize its sales strategy through a combination of Clara and its regular tender process.

Operating expenses increased from \$17.7 million in Q4 2017 to \$25.8 million in Q4 2018 due to an increase in the average cost per tonne mined resulting from the transition between mining contractors during the third quarter.

Revenue, adjusted EBITDA and earnings per share performance were as expected and reflect the overall timing of the Company's sales tenders.

Table 3: Operating cost per tonne of ore processed reconciliation:

	Year ended December 31,	
	2018	2017
<i>In millions of U.S. dollars with the exception of tonnes processed and operating cost per tonne processed</i>		
Operating expenses	\$ 75.7	\$ 61.9
Capitalized production stripping costs ⁽¹⁾	20.3	24.8
Net change rough diamond inventory ⁽²⁾	3.2	(0.9)
Net change ore stockpile inventory ⁽³⁾	8.4	(5.1)
Total operating costs for ore processed	107.6	80.7
Tonnes processed	2,629,048	2,335,550
Operating cost per tonne of ore processed⁽⁴⁾	\$ 40.93	\$ 34.56

⁽¹⁾ Capitalized production stripping cost in investing activities in the annual audited consolidated statements of cash flows.

⁽²⁾ Net change in rough diamond inventory for the years ended December 31, 2018 and 2017.

⁽³⁾ Net change in ore stockpile inventory for the years ended December 31, 2018 and 2017.

⁽⁴⁾ Operating cost per tonne processed for the period is a non-IFRS measure defined as the sum of operating expenses, capitalized production stripping costs, and the net changes in rough diamond inventories and ore stockpiles divided by the tonnes of ore processed for the period.

SELECT ANNUAL FINANCIAL INFORMATION

Table 4: <i>In millions of U.S. dollars unless otherwise noted</i>	Year ended December 31,		
	2018	2017	2016
Revenues	\$ 176.2	\$ 220.8	\$ 295.5
Operating expenses	(75.7)	(61.9)	(56.1)
Operating earnings ⁽¹⁾	100.5	158.9	239.4
Royalty expenses	(17.6)	(22.1)	(29.5)
Exploration expenditures	(3.4)	(4.8)	(4.1)
Administration	(16.4)	(15.2)	(14.9)
Sales and marketing	(2.6)	(3.3)	(5.5)
Adjusted EBITDA ⁽²⁾	60.5	113.5	185.4
Depletion and amortization	(31.4)	(15.3)	(15.9)
Finance expenses	(2.6)	(2.4)	(1.5)
Foreign exchange loss	(2.3)	(5.6)	(11.0)
Loss on disposition - Mothae	-	-	(1.2)
Gain on contractor settlement	-	7.0	-
Current income tax expense	(5.9)	(14.8)	(85.6)
Deferred income tax expense	(6.7)	(17.3)	0.5
Net income for the year	11.6	65.1	70.7
Earnings per share (basic)	0.03	0.17	0.19
Earnings per share (diluted)	0.03	0.17	0.18
Per carats sold:			
Sales price	\$ 502	\$ 847	\$ 824
Operating expenses	216	238	156
Average grade (carats per hundred tonnes)	13.9	10.7	13.5
Cash on hand	\$ 24.4	\$ 61.1	\$ 53.3
Total assets	370.1	365.8	302.0
Total non-current financial liabilities	93.7	91.9	66.2
Change in cash during the year	(36.7)	7.7	(81.4)
Dividends paid during the year	(30.3)	(29.4)	(149.7)

⁽¹⁾ Operating earnings is a non-IFRS measure defined as sales less operating expenses.

⁽²⁾ Adjusted EBITDA is a non-IFRS measure defined as earnings before interest, taxation, depreciation and amortization.

Revenues

Total sales of \$176.2 million for 2018 surpassed 2017's total revenue of \$167.8 million, adjusted for the sale of the LLR. During the year ended December 31, 2018, Lucara sold 350,798 carats at an average price of \$502 per carat. During the year ended December 31, 2017, Lucara sold 260,526 carats for total sales of \$220.8 million or \$847 per carat. The sale of the LLR for \$53 million in Q3 2017 had a significant impact on 2017 revenue at \$47,777 per carat. Adjusting for the sale of the LLR, comparable revenues for the year ended December 31, 2017 were \$167.8 million or \$647 per carat. 2018 revenue was consistent with guidance. The Company has also been building inventory for Clara that will be made available for sale through the ramp up period, based on demand, estimated to have a realized value of approximately \$2.3 million.

2018 saw a record number of Specials recovered from the Karowe Diamond Mine, however, variability in the natural colour and clarity of the diamonds recovered in conjunction with higher volumes of finer diamonds and weaker market conditions in that end of the market resulted in a lower average price per carat than was achieved in prior years. While 2018 was a record year for the number of Specials recovered, the overall average price for Specials sold in 2018 was lower than in previous years due to the quality of some of the larger Specials recovered. While sales of individual stones at prices between \$2 million and \$5 million were consistent with previous years, in 2018 no individual stones were sold at prices between

\$5 million and \$10 million (as compared to 1 to 3 stones each year between 2015 and 2017) and only one stone sold for more than \$10 million. As a result, revenue of \$176.2 million was at the lower end of original guidance for 2018 (\$170 million to \$200 million) and slightly below revised guidance (\$180 million to \$190 million).

Processing improvements at the mine contributed to an improvement in the number of carats recovered, though the impact to revenue was modest as the increase was largely due to finer diamonds recovered as compared to 2017 (excluding the sale of the LLR). On average, single stone sales generate 60% to 70% of total annual revenue.

Operating Earnings and Expenses

Operating earnings for the year ended December 31, 2018 were \$100.5 million (2017: \$158.9 million) and operating expenses during the year totalled \$75.7 million or \$216 per carat (2017: \$61.9 million or \$238 per carat), which resulted in an operating margin (before royalties, depletion and amortization) of \$286 per carat or 57% (2017: \$609 per carat or 72%). Operating expenses increased about 22%, which is a reflection of the higher cost per tonne mined and one-time costs related to the mining contractor transition. The average operating margin in 2017 was positively affected by the sale of the LLR. Excluding the LLR, a comparable operating margin of \$408 per carat was achieved or 63% in 2017.

Lucara achieved an average grade of 13.9 carats per hundred tonnes ("cpht") during the year compared to 10.7 cpht in the prior year and a 47% increase in carat recoveries (2018: 366,086 carats; 2017: 249,767 carats). This significant increase in carat recoveries in the smaller sizes reduced the average price per carat sold and reduced the average operating margin per carat when compared to 2017 (\$286 per carat vs. \$408 per carat). A comparable operating margin percentage (57% vs. 63%) was maintained if the contribution from the LLR (\$53.0 million) is excluded.

Depletion and amortization

The Company incurred a depletion and amortization charge of \$31.4 million (2017: \$15.3 million) which is due to a change in the reserve base following an update to the Mineral Resource Estimate mid-2018 and a significant increase in the number of carats sold during the year (350,798 carats in 2018 vs. 260,526 carats in 2017). Higher capitalized production stripping through 2017 and 2018 and amortization expense on production assets which were commissioned in Q3 2017 also contributed to an increase in this expense for the year. Depletion expense on assets that are amortized on a unit of production basis, including stripping costs, is more significantly affected by the volume of carats recovered in any given year. A 35% increase in the number of carats sold during 2018 compared to 2017 results in a significant impact to the expense which is recorded on a per unit basis, irrespective of the revenue generated per carat.

Net income

Net income for the year ended December 31, 2018 was \$11.6 million (2017: net income of \$65.1 million, including gross proceeds of \$53 million from the sale of LLR in 2017). Higher operating expenses and a higher depletion and amortization expense offset by lower tax movements accounted for the remaining impact on the decrease in net income as compared to the same period in 2017.

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

Adjusted EBITDA for the year ended December 31, 2018 was \$60.5 million compared to \$113.5 million in 2017. The period to period change is largely attributable to the sale of the LLR during 2017.

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

Operating Cost Per Tonne of Ore Processed

For the year ended December 31, 2018, operating cost per tonne processed was \$40.93 (2017: \$34.56). This increase is consistent with the Company's expectations following a change in the mining contractor mid-year, which resulted in a higher unit cost per tonne mined. A higher volume of ore mined resulted in higher mining costs (2018: 3.1 million tonnes; 2017 – 1.6 million tonnes) whilst a similar level of ore was processed, and significant net changes in both the rough diamond inventory (+ \$3.2 million) and the ore stockpile inventory (+ \$ 8.4 million) offset by a lower amount of production stripping capitalized (net decrease of \$4.5 million) contributed to the significant increase in the operating cost per tonne processed as compared to 2017.

Operating cost per tonne processed is a non-IFRS measure and is reconciled in Table 4 above to the most directly comparable measure calculated in accordance with IFRS, which is operating expenses.

QUARTERLY RESULTS OF OPERATIONS

Table 5: Karowe Diamond Mine, Botswana

	UNIT	Q4-18	Q3-18	Q2-18	Q1-18	Q4-17
Sales						
Revenues	US\$M	40.6	45.7	64.5	25.4	37.1
Proceeds generated from sales tenders conducted in the quarter are comprised of:	US\$M	40.6	41.8	68.4	25.4	37.1
Sales proceeds received during the quarter	US\$M	40.6	45.7	64.5	25.4	37.1
Q2 2018 tender proceeds received post Q2 2018	US\$M	-	(3.9)	3.9	-	-
Carats sold for proceeds generated during the period	Carats	110,553	89,461	87,467	63,317	69,358
Carats sold for revenues recognized during the period	Carats	110,553	101,600	75,329	63,317	69,358
Average price per carat for proceeds generated during the period	US\$	367	467	782 ¹	401	535
Average price per carat for proceeds received during the period	US\$	367	450	856 ¹	401	535
Production						
Tonnes mined (ore)	Tonnes	563,279	1,217,016	702,825	630,242	624,749
Tonnes mined (waste)	Tonnes	2,743,586	3,850,225	4,416,361	3,991,648	4,745,609
Tonnes processed	Tonnes	602,376	728,962	698,303	599,407	631,777
Average grade processed	cpht (*)	13.6	17.4	11.7	12.6	10.2
Carats recovered	Carats	81,850	127,031	81,507	75,698	64,477
Costs						
Operating costs per carats sold (see page 12 Non-IFRS measures)	US\$	233	185	220	231	255
Capital expenditures	US\$M	6.5	2.4	2.7	3.9	9.6

(*) carats per hundred tonnes

(1) This includes one exceptional stone tender sale of \$32.4 million in addition to one regular stone tender during the quarter

FOURTH QUARTER OVERVIEW – OPERATIONS - KAROWE DIAMOND MINE

Safety: Karowe had no lost time injuries during the three months ended December 31, 2018 resulting in a twelve-month rolling Lost Time Injuries Frequency Rate ("LTIFR") of 0.

Production: Ore and waste mined during the fourth quarter of 2018 totaled 0.6 million tonnes and 2.7 million tonnes respectively. Tonnage processed was within forecast at 0.6 million tonnes, with a total of 81,850 carats recovered. Ore processed was predominantly from the South Lobe. During Q4, a total of 161 Specials (single diamonds larger than 10.8 carats) were recovered including seven diamonds greater than 100 carats in weight and one diamond greater than 200 carats. Recovered Specials equated to 6.8% weight percentage of total recovered carats during the year, the second year to achieve this record weight, in line with expectations.

Beginning in the fourth quarter, Trollope Mining Services Pty ("Trollope") was responsible for all waste and ore mining. Performance improved considerably through the fourth quarter. Deficiencies in waste mining during the first half of the year were reversed and a total of 15.0 million tonnes of waste was moved during the year, meeting guidance (13 to 16 million tonnes). A change in the mine plan following the Mineral Resource update mid-year has resulted in a larger volume of ore mined than originally anticipated. A total of 3.1 million tonnes of ore was mined for the year, surpassing the original guidance of 2.5 – 2.8 million tonnes and meeting revised guidance of 2.9 – 3.1 million tonnes. The additional ore is lower-grade and has been stockpiled for processing at a later date.

Karowe's operating cash cost: Karowe's full year 2018 operating cash cost (see page 12 Non-IFRS measures) was \$40.93 per tonne processed (2017: \$34.56 per tonne processed) compared to the full year forecast of \$38-\$42 per tonne processed. The increase in cost per tonne processed compared to the prior year comparable periods reflects an increase in total mining costs as tonnes mined was higher (2018: 18.1 million tonnes mined vs. 2017: 17.4 million tonnes mined) whilst a comparable level of tonnes was processed in addition to the change in mining contractor, as discussed previously.

Labour relations update: During the second half of 2018, a number of meetings and joint training between the Botswana Mine Workers Union and Karowe management took place and an experienced facilitator was appointed. Presently, both sides are working to conclude a Memorandum of Agreement ("MOA") which will govern the working relationship between the two parties.

MINERAL RESOURCE UPDATE AND BOTSWANA EXPLORATION

Karowe Resource (AK06 kimberlite) Update

During Q2 2018, an updated mineral resource was announced for the AK06 kimberlite. The updated Mineral Resource Estimate was completed by Mineral Services Canada Inc. The estimate is based on historical evaluation data combined with new sampling results (microdiamond, bulk density and petrography) from recent deep core drilling and from historical drill cores. New delineation drill coverage and review of historical drill cores supported an update of the internal geological model. Production data (including a controlled production run from the Eastern magmatic/pyroclastic kimberlite ("EM/PK(S)") unit) and recent sales and valuation results have been incorporated into the grade and value estimates, which have been made based on an updated model of process plant recovery efficiency. The updated Mineral Resource is reported based on the Canadian Institute of Mining Definition Standards for Mineral Resources and Reserves as incorporated by National Instrument 43-101 *Standards of Disclosure for Mineral Projects*.

In 2018, following the release of a positive Preliminary Economic Assessment ("PEA") in November 2017, the Company embarked on a US\$29 million technical program to support a Feasibility Level study ("FS") for a potential underground operation at the Karowe Diamond Mine. This program included the completion of the above noted mineral resource update, geotechnical drilling of the country rock and AK06 kimberlite, hydrogeological drilling and modelling, and mining trade off studies to address risks and issues identified during the PEA. A total of US\$21.0 million was spent out of a 2018 budget of US\$29 million in support of this work, which resulted in significant de-risking of the key technical components associated with the potential underground development.

During 2018, 33 core holes totaling 20,283 metres were drilled representing approximately 83% of the originally planned drilling. Drilling will continue into late Q1 2019 and will focus on deep granite/kimberlite intersections with the final receipt of all data by mid to late Q2 2019. Data collection is underway consisting of detailed geotechnical and geological logging, density measurements, point load and other geotechnical rock strength testing. As data is received results will be incorporated into the rock mass model and used as part of the mining method selection. Data collection within the country rock has accounted for approximately 38% of the completed drilling and will provide detailed information with respect to the rock mass qualities of the host Karoo sequence at Karowe. Approximately 35% of the drilling has targeted the AK06 kimberlite at various elevations to achieve increased data on the nature of the kimberlite /country rock contacts in various rock types and to provide additional data within the deeper portions of the South

Lobe. No major risks have been identified during drilling or with data collected from geotechnical rock testing.

The main objective of the hydrogeological program was to quantify the mine dewatering and depressurization requirements to continue the successful de-watering of the open pit and to identify the immediate and ongoing de-watering requirements for the potential underground mining operations. A total of four deep bore holes were drilled to assess the deep hydrogeological conditions at Karowe. Regionally and as documented at other diamond mines in the area, the contact between the Tlapana Formation (carbonaceous shales) and the basement granites was separated by the Mea Arkose Formation. The Mea Formation, at other locations where examined, has formed a basal aquifer containing hot, pressurized saline water. Three of the 4 deep hydrogeological evaluation boreholes were designed to target and test the potential existence of a deep basal aquifer at 400 m depth below surface. Drilling encountered limited water strikes, providing no evidence for such an aquifer. This positively addressed one of the key risks identified during the PEA study.

Botswana Prospecting Licenses:

In Q3 2018, the AK11/24 license (PL371/2014) was reduced by 50% in area and extended for two periods until the third quarter of 2019. At AK24, four holes were sampled for microdiamonds and samples were shipped to the Saskatchewan Research Council. Microdiamond results were received in Q4 2018, although diamondiferous, microdiamond counts were low and no further work is planned for AK24.

Sunbird Exploration Generative Project:

During Q2 2018, an agreement was signed with a Botswana company, Sunbird, to focus on the discovery of new kimberlites within the country using a proprietary UAV magnetometer platform to identify targets. Data acquisition commenced during Q2 2018 and continued through Q4 2018 incorporating over 50,000 line kilometres of high resolution magnetics. Drilling of selected targets commenced in late Q3 2018 and continued into Q4 2018. Though no kimberlites have been discovered to date, work will continue in 2019 on other significant targets identified. This work is being funded from the original exploration budget of \$6.0 million for fiscal 2018. Thirty-seven prospecting licenses covering 14,862 hectares in highly prospective regions in Botswana are held by Sunbird, pursuant to this exploration agreement.

CORPORATE UPDATE

Acquisition of Clara Diamond Solutions Corp.

In February 2018, Lucara completed the acquisition of Clara (see announcement February 26, 2018), a company whose primary asset is a secure, digital diamond sales platform that combines proprietary analytics with existing cloud and blockchain technologies to transform how rough diamonds are sold. This transaction was accounted for as an asset acquisition and the consideration paid was categorized as intangible assets. As up-front consideration for the acquisition, Lucara issued 13.1 million shares with a value of \$21.5 million and paid acquisition costs of \$0.4 million. Further staged equity payments totalling 13.4 million shares become payable upon the achievement of performance milestones related to total revenues (revenues from rough diamonds bought and sold) generated through the platform. Lucara has also agreed to a profit sharing mechanism whereby the founders and facilitators of the Clara technology, as well as the Clara management team, will retain 13.33% and 6.67%, respectively, of the annual EBITDA generated by the platform, to a maximum of US\$25 million per year, for ten years. This contingent consideration will be recognized as additional purchase consideration for the intangible asset, if the performance milestones are reached.

Commercialization efforts for the Clara digital diamond sales platform continue on budget and on schedule with the first sale completed in December 2018. Rough diamonds offered in Clara's first sale included a selection of diamonds from Lucara's Karowe Diamond Mine and additional aggregated third-party rough diamonds consisting of stones between one and four carats in size in the better colours and qualities. In 2019, Clara's objective is to on-board production from other sources and open the platform to a broad

range of customers, including diamond manufacturers and jewelry houses. Testing on the platform has demonstrated the potential to unlock greater than 18-23% of value throughout the diamond pipeline to the benefit of all participants. Clara's revenue model will be based on capturing a portion of this incremental value. During 2018, the Company capitalized \$1.8 million to intangible assets related to the development of the Clara platform and recognized its first sales on the platform of \$0.7 million. Clara's profit from the inaugural sale was recorded as a development cost as the platform did not achieve commercial production in 2018.

LIQUIDITY AND CAPITAL RESOURCES

As at December 31, 2018, the Company had cash and cash equivalents of \$24.4 million. Spending during the year ended December 31, 2018 was focused on investments in the business including mineral property expenditures of \$20.3 million (2017: \$1.2 million), capitalized production stripping of \$21.4 million (2017: \$24.8 million), acquisition of plant and equipment assets of \$16.4 million (2017: \$34.2 million) and dividends paid of \$30.3 million (2017: \$29.4 million). Exploration activities of \$3.0 million (2017: \$4.8 million) were also undertaken to identify potential new kimberlite discoveries.

Working capital as at December 31, 2018 was \$48.8 million as compared to \$83.6 million as at December 31, 2017. The decrease in working capital reflects a smaller cash balance as at December 31, 2018 partially offset by a higher inventory balance due to a larger number of ore tonnes processed and carats recovered during the year ended December 31, 2018.

The Company had \$10.1 million drawn on its credit facility at December 31, 2018 to facilitate timing of working capital needs. Amounts undrawn under the credit facility were \$40.0 million as of December 31, 2018. Long-term liabilities consist of restoration provisions of \$20.2 million (2017: \$18.9 million) and deferred income taxes of \$73.5 million (2017: \$72.9 million).

Total shareholders' equity decreased from \$256.7 million as at December 31, 2017 to \$241.9 million as at December 31, 2018. There was a decrease in the deficit of \$21.8 million resulting from net income of \$11.7 million offset by dividends paid of \$30.3 million. Share capital increased by \$21.5 million as a result of common shares issued to acquire Clara, \$1.1 million from share units vested and \$0.3 million from the exercise of stock options. Accumulated other comprehensive loss increased to \$58.0 million, primarily from a \$17.8 million currency translation adjustment.

SUMMARY OF QUARTERLY RESULTS

(All amounts expressed in thousands of U.S. dollars, except per share data). The Company's interim consolidated financial statements are reported under IFRS applicable to interim financial reporting.

Table 6: The following table provides highlights, extracted from the Company's consolidated financial statements, of quarterly results for the past eight quarters:

Three months ended	Dec-18	Sept-18	Jun-18	Mar-18	Dec-17	Sept-17	Jun-17	Mar-17
A. Revenues	40,609	45,669	64,539	25,374	37,143	77,911	79,615	26,094
B. Administration expenses	(4,369)	(2,849)	(3,342)	(5,831)	(6,071)	(3,163)	(2,975)	(3,025)
C. Net income (loss)	(6,225)	5,136	19,698	(6,957)	1,571	32,903	32,174	(1,531)
D. Earnings (loss) per share (basic and diluted)	(0.02)	0.01	0.05	(0.02)	-	0.09	0.08	(-)

The Company's quarterly results, including net income and earnings (loss) per share are most directly affected by the sale of unique and high value diamonds. In September 2017, the Company sold the 1,109 carat LLR for US\$53 million (\$47,777 per carat), resulting in total revenues of \$77.9 million for the quarter.

The Company's only Exceptional Stone Tender ("EST") of 2018 occurred during the three months ended June 30, 2018 and contributed \$32.5 million of the total revenues of \$64.5 million recognized during the quarter. This compares to the first EST of 2017 which occurred during the three months ended June 30, 2017 and contributed \$54.8 million out of total revenues of \$79.6 million.

Revenue from the sale of diamonds from the Karowe Diamond Mine sold on the Clara platform is included in total revenue of \$40.6 million for the three months ended December 31, 2018.

2019 OUTLOOK

This section of the MD&A provides management's production and cost estimates for 2019. These are "forward-looking statements" and subject to the cautionary note regarding the risks associated with forward-looking statements. No changes have been made to our 2019 outlook previously provided.

Karowe Mine, Botswana

Table 7: 2019 Diamond Sales, Production and Outlook

Karowe Diamond Mine	Full Year – 2019
<i>In millions of U.S. dollars unless otherwise noted</i>	
Diamond revenue (millions)	\$170 to \$200
Diamond sales (thousands of carats)	300 to 320
Diamonds recovered (thousands of carats)	300 to 330
Ore tonnes mined (millions)	2.5 to 2.8
Waste tonnes mined (millions)	6.0 to 9.0
Ore tonnes processed (millions)	2.5 to 2.8
Total operating cash costs ⁽¹⁾ including waste mined ⁽²⁾ (per tonne processed)	\$32.00 to \$37.00
Operating cash costs excluding waste mined (per tonne processed)	\$21.00 to \$24.00
Botswana general & administrative expenses including marketing costs (per tonne processed)	\$2.00 to \$3.00
Tax rate	22% to 29%
Average exchange rate – USD/Pula	10.5

(1) Operating cash costs are a non-IFRS measure. See "Non-IFRS Measures" on page 11.

(2) Includes ore and waste mined cash costs of \$4.00 to \$4.50; processing cash costs of \$12.00 to \$13.00 and mine-site departmental costs (security, technical services, mine planning, health & safety, geology) of \$5.00 to \$6.00 (all dollar figures in per tonne mined or processed).

Following the substantial completion of a significant waste stripping campaign in 2017 and 2018, total tonnes mined in 2019 are expected to be between 8.5 million and 11.8 million tonnes, of which the Company expects to mine between 2.5 million to 2.8 million tonnes of ore and between 6.0 and 9.0 million tonnes of waste. The average strip ratio is expected to be 2.84 in 2019.

The 2019 estimated cash cost per tonne of ore processed is expected to be between \$32.00 and \$37.00 (2018: \$38.00 to \$42.00) while estimated operating cash costs, excluding waste mining, are expected to be between \$21.00 and \$24.00 per tonne processed. The cost per tonne mined is expected to be between \$4.00 and \$4.50 and the estimated processing cost per tonne processed is expected to be between \$12.00 and \$13.00, mostly offsetting the increase in cost per tonne mined which results from higher rates from the mining contractor appointed in mid-2018.

In 2019, the Company forecasts revenues between \$170 million and \$200 million, consistent with the forecast for 2018. These projections include "Specials" which are diamonds that are 10.8 carats and larger but exclude the sale of any truly unique diamonds such as the 1,109 carat LLR (sold in 2017 for \$53 million) and the 813 carat Constellation (sold in 2016 for \$63.1 million). Specials are consistently recovered from the Karowe Diamond Mine and those Specials which are gem-quality contribute a significant percentage of the Company's annual revenue. In 2019, diamonds recovered are expected to be between 300,000 carats and 330,000 carats and diamonds sold are expected to be between 300,000 carats and 320,000 carats.

Sustaining capital and project expenditures are expected to be up to \$14.0 million in 2019, including expenditures associated with the construction of an additional slimes dam, improvements related to the XRT recovery circuit, and a provision for the implementation of body scanning technology to enhance

security. This does not include investments being made on the underground development study noted below.

A budget of \$14.8 million has been approved to complete a feasibility study that was initiated in 2018, evaluating the potential for an underground mining operation at Karowe. Work undertaken in 2018 has significantly de-risked the project and in 2019, efforts will focus on follow up geotechnical and hydrogeological drilling and related studies. Exploration expenditures are estimated to be up to \$3.0 million for use of the Sunbird remote mapping technology and drilling of prospective targets identified by the technology.

NON-IFRS FINANCIAL MEASURES

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

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

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

Operating cost per tonne of ore processed (see "Select Financial Information") is the term the Company uses to describe operating expenses per tonne processed on a cash basis. This is calculated as Operating cost divided by tonnes of ore processed for the period. This ratio provides the user with the total cash costs incurred by the mine during the period per tonne of ore processed, including waste capitalisation costs, mobilization costs and working capital movements. The most directly comparable measure calculated in accordance with IFRS is operating expenses. A table reconciling the two measures is presented in table 5.

RELATED PARTY TRANSACTIONS

A description of key management compensation can be found in Note 18 of the audited consolidated financial statements for the year ended December 31, 2018.

In February 2018, certain related parties received Lucara common shares in exchange for the Clara common shares they owned prior to Lucara's acquisition of Clara. These related parties will receive additional shares of Lucara if Clara, now a wholly-owned subsidiary of Lucara, achieves certain levels of revenue generated by sales on the platform (the "Performance Milestones"). The Performance Milestones are detailed in Note 9 of the audited consolidated financial statements for the year ended December 31, 2018.

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

Pursuant to the profit sharing mechanism described above, a total of 3.45% of the EBITDA generated by the platform has been assigned to Ms. Thomas and Ms. McLeod-Seltzer. A further 3.22% of the EBITDA generated by the platform to be distributed to management, including Mr. Armstrong and Ms. Boldt, at the discretion of Lucara's compensation committee based on key performance targets.

FINANCIAL INSTRUMENTS

The Company amended its financial instrument accounting policy as a result of the adoption of IFRS 9. No adjustments were required from this adoption. IFRS 9, Financial Instruments addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 requires financial assets to be classified into three measurement categories on initial recognition: those measured at fair value through profit and loss, those measured at fair value through other comprehensive income and those measured at amortized cost. Investments in equity instruments are required to be measured by default at fair value through profit or loss. However, there is an irrevocable option to present fair value changes in other comprehensive income. Measurement and classification of financial assets is dependent on the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset.

IFRS 9 introduces a new three-stage expected credit loss model for calculating impairment for certain financial assets. IFRS 9 no longer requires a triggering event to have occurred before credit losses are recognized. An entity is required to recognize expected credit losses when financial instruments are initially recognized and to update the amount of expected credit losses recognized at each reporting date to reflect changes in the credit risk of the financial instruments. In addition, IFRS 9 requires additional disclosure requirements about expected credit losses and credit risk. There was no significant measurement or disclosure impact on the financial statements from this adoption.

In the normal course of business, the Company is inherently exposed to currency and commodity price risk. For a discussion of certain risks and assumptions that relate commodity price risk, currency risk, liquidity risk and credit risk, refer to Note 20 in the Company's audited consolidated financial statements for the year ending December 31, 2018. Note 20 also includes a discussion of the methods used to value financial instruments, as well as any significant assumptions made as part of the valuation.

OUTSTANDING SHARE DATA

As at the date of this MD&A, the Company had 396,509,387 common shares outstanding, 1,283,045 share units and 4,278,336 stock options outstanding under its stock-based incentive plans.

RISKS AND UNCERTAINTIES

The operations of the Company are speculative due to the high-risk nature of its business which includes the acquisition, financing, exploration, development and operation of diamond properties and the recent acquisition of Clara in February 2018. The material risk factors and uncertainties, which should be taken into account in assessing the Company's activities, are described under the heading "Risks and Uncertainties" in the Company's most recent Annual Information Form available at <http://www.sedar.com> (the "AIF"). Any one or more of these risks and uncertainties could have a material adverse effect on the Company.

OFF-BALANCE SHEET ARRANGEMENTS

Other than in respect of operating lease arrangements for offices in Botswana, the Company is not party to any off-balance sheet arrangements.

ANNUAL INFORMATION

The Company's annual general meeting of shareholders will be held on May 10, 2019 in Toronto, Canada.

CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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, 2018 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.

Estimated Recoverable Reserves and Resources

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

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

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

Mineral Properties

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

The Company 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. Following the release of a new Mineral Resource Estimate for Karowe in mid-2018, the remaining life-of-mine reserve base was adjusted, resulting in a higher depletion rate than in previous years. These estimates are subject to various risks and uncertainties, which may ultimately have an effect on the expected recoverability of the carrying values of the mineral properties and related expenditures.

Income Taxes

The deferred tax provisions are calculated by the Company whilst the actual amounts of income tax expense are not final until tax returns are filed and accepted by the relevant authorities. Judgment is required in assessing whether deferred tax assets and certain deferred tax liabilities are recognized on the balance sheet and what tax rate is expected to be applied in the year when the related temporary differences

reverse. Deferred tax liabilities arising from temporary differences are recognized unless the reversal of the temporary differences is not expected to occur in the foreseeable future and can be controlled. Assumptions about the generation of future taxable profits and repatriation of retained earnings depend on management's estimates of future production and sales volumes, diamond prices, reserves and resources, operating costs, decommissioning and restoration costs, capital expenditures, dividends and other capital management transactions. These estimates and judgments are subject to risk and uncertainty and could result in an adjustment to the deferred tax provision and a corresponding credit or charge to profit.

Decommissioning and Site Restoration

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

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

CHANGES IN ACCOUNTING POLICIES

New accounting pronouncements

In 2016, the IASB issued IFRS 16 Leases, which requires lessees to recognize assets and liabilities for most leases. The new Leases standard requires lessees to recognize leases traditionally recorded as operating leases in the same manner as financing leases. IFRS 16 will be effective for annual periods beginning on or after January 1, 2019, with early adoption permitted. The Company has completed its assessment of the adoption of the standard and has adopted the standard as of January 1, 2019. The Company has several office leases previously treated as operating leases that will be recorded to the balance sheet by recording an asset for the use of the leased premises and corresponding obligation. The cumulative effect of the change in lease treatment is not material.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

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

INTERNAL FINANCIAL REPORTING AND DISCLOSURE CONTROLS

Disclosure controls and procedures

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it

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

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. As of December 31, 2018, the Chief Executive Officer and Chief Financial Officer have each concluded that the Company's disclosure controls and procedures, as defined in NI 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to achieve the purpose for which they have been designed.

Internal controls over financial reporting

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

The Company's internal controls over financial reporting include policies and procedures that: pertain to the maintenance of records that, in reasonable detail accurately and fairly reflect the transactions and disposition of assets; provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with IFRS and that receipts and expenditures are being made only in accordance with authorization of management and directors of the Company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements.

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's internal controls over financial reporting. As of December 31, 2018, the Chief Executive Officer and Chief Financial Officer have each concluded that the Company's internal controls over financial reporting, as defined in NI 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to achieve the purpose for which they have been designed.

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

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

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

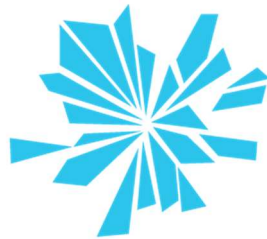
In particular, this MD&A may contain forward looking information pertaining to the following: the estimates of the Company's mineral reserves and resources; estimates of the Company's production and sales volumes for the Karowe Diamond Mine; estimated costs for capital expenditures related to the Karowe Diamond Mine; 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 rates; expectations in respect of the development and functionality of the technology related to the Clara platform, the intended benefits and performance of

the Clara platform, including achieved margins in pricing, the timing and cost of commercialization and operation of the Clara platform, the timing and frequency of sales on the Clara Platform, and future participation of third parties on the Clara platform; expectations regarding the need to raise capital; possible impacts of disputes or litigation; and other risks and uncertainties described under the heading "Risks and Uncertainties" in the Company's most recent Annual Information Form available at <http://www.sedar.com> (the "AIF").

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

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

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



LUCARA

DIAMOND

Consolidated Financial Statements
For the year ended December 31, 2018



Independent auditor's report

To the Shareholders of Lucara Diamond Corp.

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Lucara Diamond Corp. and its subsidiaries, (together, the Company) as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

What we have audited

The Company's consolidated financial statements comprise:

- the consolidated balance sheets as at December 31, 2018 and 2017;
- the consolidated statements of operations for the years then ended;
- the consolidated statements of comprehensive income (loss) for the years then ended;
- the consolidated statements of cash flows for the years then ended;
- the consolidated statements of changes in equity for the years then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

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

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

Independence

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

PricewaterhouseCoopers LLP

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



Other information

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

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

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

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

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

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

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

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

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

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



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

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

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



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

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

(Signed) "PricewaterhouseCoopers LLP"

Chartered Professional Accountants

Vancouver, British Columbia
February 21, 2019

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

	December 31, 2018	December 31, 2017
ASSETS		
Current assets		
Cash and cash equivalents	\$ 24,355	\$ 61,065
VAT receivables and other (Note 5)	11,583	3,951
Inventories (Note 6)	48,146	35,898
	84,084	100,914
Investments	920	2,500
Plant and equipment (Note 7)	147,246	167,576
Mineral properties (Note 8)	113,109	90,559
Intangible assets (Note 9 and 10)	21,798	-
Other non-current assets	3,738	4,261
TOTAL ASSETS	\$ 370,895	\$ 365,810
LIABILITIES		
Current liabilities		
Trade payables and accrued liabilities	\$ 21,204	\$ 16,780
Credit facility (Note 20)	10,111	-
Taxes payable	3,999	494
	35,314	17,274
Restoration provisions (Note 11)	20,184	18,941
Deferred income taxes (Note 15)	73,482	72,919
TOTAL LIABILITIES	128,980	109,134
EQUITY		
Share capital (unlimited common shares, no par value)	313,913	290,846
Contributed surplus	7,766	7,832
Deficit	(21,767)	(3,043)
Accumulated other comprehensive loss	(57,997)	(38,959)
TOTAL EQUITY	241,915	256,676
TOTAL LIABILITIES AND EQUITY	\$ 370,895	\$ 365,810

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

Approved on Behalf of the Board of Directors:

"Marie Inkster"
Director

"Brian Edgar"
Director

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

	2018	2017
Revenues	\$ 176,191	\$ 220,763
Cost of goods sold		
Operating expenses	75,731	61,851
Royalty expenses (Note 8)	17,619	22,076
Depletion and amortization	31,405	15,362
	124,755	99,289
Income from mining operations	51,436	121,474
Other expenses		
Administration (Note 14)	16,391	15,234
Exploration expenditures	3,359	4,754
Finance expenses	2,552	2,358
Foreign exchange loss	2,338	5,652
Sales and marketing	2,599	3,253
Gain on contractor settlement (Note 17)	-	(6,996)
	27,239	24,255
Net income before tax	24,197	97,219
Income tax expense (Note 15)		
Current income tax expense	5,857	14,841
Deferred income tax expense	6,688	17,261
	12,545	32,102
Net income for the year	\$ 11,652	\$ 65,117
Earnings per common share (Note 16)		
Basic	\$ 0.03	\$ 0.17
Diluted	\$ 0.03	\$ 0.17
Weighted average common shares outstanding (Note 16)		
Basic	394,008,955	382,619,294
Diluted	395,513,705	384,072,810

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

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

		2018		2017
Net income for the year	\$	11,652	\$	65,117
Other comprehensive income (loss)				
Items that will not be reclassified to net income				
Change in fair value of marketable securities		(1,187)		28
Items that may be subsequently reclassified to net income				
Currency translation adjustment		(17,851)		18,840
		(19,038)		18,868
Comprehensive income (loss)	\$	(7,386)	\$	83,985

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

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

	2018	2017
Cash flows from (used in):		
Operating Activities		
Net income for the year	\$ 11,652	\$ 65,117
Items not involving cash and cash equivalents:		
Depletion and amortization	31,741	15,968
Unrealized foreign exchange loss	2,338	5,652
Stock-based compensation	1,447	1,484
Deferred income taxes	6,688	17,261
Finance costs	2,503	2,293
Gain on contractor settlement (Note 17)	-	(6,996)
	56,369	100,779
Net changes in working capital items:		
VAT receivables and other	(8,162)	3,992
Inventories	(13,090)	4,520
Trade payables and other current liabilities	6,258	(3,743)
Taxes payable	3,737	(8,707)
	45,112	96,841
Financing Activities		
Dividends paid	(30,274)	(29,415)
Credit facility, net	10,000	-
Proceeds from exercise of stock options	327	632
Withholding tax for share units vested	(364)	-
	(20,311)	(28,783)
Investing Activities		
Acquisition and disposition of plant and equipment, net	(17,146)	(34,204)
Capitalized mineral property expenditure	(20,266)	(1,223)
Capitalized production stripping costs	(21,425)	(24,752)
Development of intangible assets	(1,800)	-
Acquisition of other assets	(81)	(822)
	(60,718)	(61,001)
Effect of exchange rate change on cash and cash equivalents	(793)	663
Increase (decrease) in cash and cash equivalents during the year	(36,710)	7,720
Cash and cash equivalents, beginning of year	61,065	53,345
Cash and cash equivalents, end of year⁽¹⁾	\$ 24,355	\$ 61,065
Supplemental Information		
Interest received	95	431
Taxes paid	(5,429)	(23,357)
Changes in trade payables and accrued liabilities related to plant and equipment	198	804

⁽¹⁾ Cash and cash equivalents are composed of 100% cash deposits held with accredited financial institutions at the end of the year.

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

LUCARA DIAMOND CORP.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

FOR THE YEARS ENDED DECEMBER 31

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

	Number of shares issued and outstanding	Share capital	Contributed surplus	Retained earnings (deficit)	Accumulated other comprehensive loss	Total
Balance, January 1, 2017	382,246,001	\$ 289,969	\$ 6,488	\$ (38,640)	\$ (57,827)	\$ 199,990
Exercise of stock options	373,333	877	(245)	-	-	632
Stock-based compensation	-	-	1,484	-	-	1,484
Effect of foreign currency translation	-	-	-	-	18,840	18,840
Change in fair value through other comprehensive income securities	-	-	-	-	28	28
Dividends paid ⁽¹⁾	-	-	105	(29,520)	-	(29,415)
Net income for the year	-	-	-	65,117	-	65,117
Balance, December 31, 2017	382,619,334	\$ 290,846	\$ 7,832	\$ (3,043)	\$ (38,959)	\$ 256,676
Balance, January 1, 2018	382,619,334	\$ 290,846	\$ 7,832	\$ (3,043)	\$ (38,959)	\$ 256,676
Exercise of stock options	200,000	441	(114)	-	-	327
Stock-based compensation	-	-	1,447	-	-	1,447
Effect of foreign currency translation	-	-	-	-	(17,851)	(17,851)
Change in fair value through other comprehensive income securities	-	-	-	-	(1,187)	(1,187)
Shares issued for Clara acquisition (Note 9)	13,100,000	21,489	-	-	-	21,489
Shares issued from SUs vested	590,053	1,137	(1,137)	-	-	-
Withholding tax for SUs vested	-	-	(364)	-	-	(364)
Dividends paid ⁽²⁾	-	-	102	(30,376)	-	(30,274)
Net income for the year	-	-	-	11,652	-	11,652
Balance, December 31, 2018	396,509,387	\$ 313,913	\$ 7,766	\$ (21,767)	\$ (57,997)	\$ 241,915

⁽¹⁾ On March 30, June 15, September 14, and December 14, 2017 the Company paid a cash dividend of CA\$0.025 per share.

⁽²⁾ On April 12, June 21, September 20, and December 20, 2018 the Company paid a cash dividend of CA\$0.025 per share.

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

LUCARA DIAMOND CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

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

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 and two prospecting licenses located in Botswana. The Company is also currently developing a secure, digital diamond sales platform (Clara Diamond Solutions Corporation) for the sale of rough diamonds that uses proprietary analytics together with cloud and blockchain technologies.

The Company’s common shares are listed on the TSX, NASDAQ Stockholm and Botswana Stock Exchanges. The Company was continued into the Province of British Columbia under the Business Corporations Act (British Columbia) in August 2004 and its registered office is located at Suite 2000 - 885 West Georgia Street, Vancouver, British Columbia, V6C 3E8.

2. BASIS OF PRESENTATION

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

These financial statements were approved by the Board of Directors for issue on February 21, 2019.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

(a) *Basis of measurement*

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

(b) *Consolidation*

These consolidated financial statements include the accounts of the Company and all of its subsidiaries (see Note 13 Principal subsidiaries).

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

(c) *Critical accounting estimates and judgments*

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

LUCARA DIAMOND CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Estimated recoverable reserves and resources – Mineral reserve and resource estimates are based on various assumptions relating to operating matters. These include production costs, mining and processing recoveries, cut-off grades, long term diamond prices and, in some cases, exchange rates, inflation rates and capital costs. Cost estimates are based on feasibility study estimates or operating history. Estimates are prepared by appropriately qualified persons, but will be affected by forecasted commodity prices, diamond prices, inflation rates, exchange rates, capital and production costs and recoveries amongst other factors. Estimated recoverable reserves and resources are used to determine the depletion and amortization of property, plant and equipment at the operating mine site, in accounting for deferred stripping costs and mineral properties, determining a deferred tax rate and in performing impairment testing. Therefore, changes in the assumptions used could affect the carrying value of assets, depletion and amortization, changes in the deferred tax rate, and impairment charges recorded in the income statement.

Valuation of mineral properties – The Company carries its mineral properties at depleted cost less any provision for impairment. The Company undertakes a periodic review of the carrying values of mineral properties as well as 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.

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

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

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

LUCARA DIAMOND CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) *Segment reporting*

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

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

(e) *Foreign currency translation*

Functional and presentation currency

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

Transactions and balances

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

Group companies

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

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

(f) *Cash and cash equivalents*

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

LUCARA DIAMOND CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) *Financial instruments*

In the current year, the Company has applied IFRS 9 Financial Instruments effective beginning January 1, 2018. The transition provisions of IFRS 9 allow an entity not to restate comparatives. There were no financial assets or financial liabilities previously designated as at fair value through profit or loss under IAS 39 that were subject to reclassification or which the Company has elected to reclassify upon the application of IFRS 9. There were also no financial assets or financial liabilities which the Group has elected to designate as at fair value through profit and loss at the date of initial application of IFRS 9.

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires. All recognized financial assets are measured subsequently at amortized cost or fair value through profit or loss or fair value through other comprehensive income.

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

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

(h) *Inventories*

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

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

LUCARA DIAMOND CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) *Plant and equipment*

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

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

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

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

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*

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

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

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

(k) *Mineral properties*

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

LUCARA DIAMOND CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(l) *Capitalized production stripping asset*

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

(m) *Intangible assets*

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

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

(n) *Contingent consideration*

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

(o) *Impairment of non-financial assets*

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

(p) *Provisions*

Asset retirement obligations

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

LUCARA DIAMOND CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

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

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.

(g) Income taxes

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

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

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

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

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

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

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

Uncertain tax positions and interest and penalties related to uncertain tax positions are accounted for under IAS 12, Income Taxes. The Company first determines whether it is more likely than not that a tax position will be sustained upon examination. If a tax position meets the more-likely-than-not recognition threshold it is then measured to determine the amount of benefit or liability to recognize in the financial statements. The tax position is measured as the amount of benefit or liability that is likely to be realized upon ultimate settlement. The Company assesses the validity of conclusions regarding uncertain tax positions on a quarterly basis to determine if facts or circumstances have arisen that might cause the Company to change their judgment regarding the likelihood of a tax position.

LUCARA DIAMOND CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(r) Share capital

Common shares are classified as equity.

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

(s) Revenue recognition

Revenues from diamond sales are recognized when the purchaser obtains control of the diamond. Control is achieved when proceeds are received and title is transferred to the purchaser according to contract terms. IFRS 15 was adopted effective January 1, 2019 and had no material impact on the Company.

(t) 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 and share units granted to employees are measured on the grant date. Stock options granted to non-employees are measured on the date that the goods or services are received.

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

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

(u) Income (loss) per share

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

(v) Leases

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.

(w) Borrowing costs

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

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4. ADOPTION OF IFRS PRONOUNCEMENTS

IFRS pronouncements that have been issued but are not yet effective are listed below. The Company plans to apply the new standards or interpretations in the annual period for which it is first required.

IFRS 16 - Leases

The new Leases standard requires lessees to recognize leases traditionally recorded as operating leases in the same manner as financing leases. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted. The Company has completed its assessment of the adoption of the standard and will apply it as of January 1, 2019. The Company has several office leases previously treated as operating leases that will be recorded to the balance sheet by recognizing an asset for the use of the leased premises and a corresponding obligation. The cumulative effect of the change in treatment of the Company's leases is not material.

5. VAT RECEIVABLES AND OTHER

		2018		2017
VAT	\$	8,967	\$	2,152
Other		652		407
Prepayments		1,964		1,392
	\$	11,583	\$	3,951

6. INVENTORIES

		2018		2017
Rough diamonds	\$	16,847	\$	13,171
Ore stockpile		20,435		12,037
Parts and supplies		10,864		10,690
	\$	48,146	\$	35,898

Inventory expensed during the year ended December 31, 2018 totaled \$75.7 million (2017 – \$61.9 million). There were no material inventory write-downs during the years ended December 31, 2018 and 2017.

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7. PLANT AND EQUIPMENT

Cost	Construction in progress	Mine and plant facilities	Vehicles	Furniture and office equipment	Total
Balance, January 1, 2017	\$ 14,766	\$ 152,851	\$ 1,348	\$ 4,421	\$ 173,386
Additions	34,522	113	42	177	34,854
Reclassification	(41,675)	40,281	444	950	-
Disposals and other	-	(547)	(56)	(183)	(786)
Translation differences	947	15,451	140	432	16,970
Balance, December 31, 2017	8,560	208,149	1,918	5,797	224,424
Additions	17,438	-	-	10	17,448
Disposals and other	-	-	-	(47)	(47)
Reclassification ¹	(19,756)	16,131	804	1,520	(1,301)
Translation differences	(581)	(17,856)	(198)	(551)	(19,186)
Balance, December 31, 2018	\$ 5,661	\$ 206,424	\$ 2,524	\$ 6,729	\$ 221,338
Accumulated amortization					
Balance, January 1, 2017	\$ -	\$ 38,407	\$ 1,131	\$ 2,343	\$ 41,881
Depletion and amortization	-	10,414	122	848	11,384
Disposals and other	-	(392)	(56)	(183)	(631)
Translation differences	-	3,875	103	236	4,214
Balance, December 31, 2017	-	52,304	1,300	3,244	56,848
Depletion and amortization	-	21,595	320	1,167	23,082
Disposals and other	-	-	-	(2)	(2)
Translation differences	-	(5,388)	(123)	(325)	(5,836)
Balance, December 31, 2018	\$ -	\$ 68,511	\$ 1,497	\$ 4,084	\$ 74,092
Net book value					
As at December 31, 2017	\$ 8,560	\$ 155,845	\$ 618	\$ 2,553	\$ 167,576
As at December 31, 2018	\$ 5,661	\$ 137,913	\$ 1,027	\$ 2,645	\$ 147,246

⁽¹⁾ Karowe mine related expenditure of \$599 was reclassified to mineral properties and \$702 was reclassified to inventory (parts and supplies) in 2018.

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8. MINERAL PROPERTIES

Cost	Capitalized production stripping asset		Karowe Mine	Total
Balance, January 1, 2017	\$	28,183	\$ 51,484	\$ 79,667
Additions		24,752	1,498	26,250
Translation differences		3,733	4,627	8,360
Balance, December 31, 2017		56,668	57,609	114,277
Additions		21,425	20,990	42,415
Reclassification ¹		-	599	599
Translation differences		(5,741)	(5,826)	(11,567)
Balance, December 31, 2018	\$	72,352	\$ 73,372	\$ 145,724
Accumulated depletion				
Balance, January 1, 2017	\$	2,825	\$ 14,684	\$ 17,509
Depletion for the period		2,244	2,195	4,439
Translation differences		362	1,408	1,770
Balance, December 31, 2017		5,431	18,287	23,718
Depletion		6,955	4,471	11,426
Translation differences		(802)	(1,727)	(2,529)
Balance, December 31, 2018	\$	11,584	\$ 21,031	\$ 32,615
Net book value				
As at December 31, 2017	\$	51,237	\$ 39,322	\$ 90,559
As at December 31, 2018	\$	60,768	\$ 52,341	\$ 113,109

⁽¹⁾ Karowe mine related expenditure of \$599 was reclassified from plant and equipment to mineral properties in 2018.

Karowe Mine

A royalty of 10% of the sales value of diamonds produced from Karowe is payable to the government of Botswana. During the year, the Company incurred a royalty expense of \$17.6 million (2017: \$22.1 million).

9. INVESTMENT IN CLARA

On March 2, 2018, the Company completed the acquisition of 100% of the issued and outstanding common shares of Clara Diamond Solutions Corporation ("Clara"), a company whose primary asset is a secure, digital platform for the sale of rough diamonds.

LUCARA DIAMOND CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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9. INVESTMENT IN CLARA (continued)

The purchase consideration was as follows:

- 13.1 million Lucara shares.
- Contingent consideration of profit sharing: cash payments based on 3.45% of the annual EBITDA generated by the sales platform. Lucara also assumed the existing 13.3% annual EBITDA performance based contingent payments within Clara payable to the founders of the technology. This totals to 16.75% of the annual EBITDA generated by the sales platform, to a maximum of \$20.9 million per year, for 10 years.
- Contingent consideration of share payments: additional Lucara shares to be issued if the revenue triggers detailed below are reached. In total, a maximum of 13.4 million Lucara shares may become payable upon the achievement of the performance milestones related to revenue generated from the digital sales platform.

Revenue Trigger	Number of shares	Expiry date
\$200 million of cumulative revenue generated by the sales platform up to the expiry date	3 million	March 2, 2028
\$400 million of cumulative revenue generated by the sales platform up to the expiry date	3 million	March 2, 2030
\$800 million of cumulative revenue generated by the sales platform up to the expiry date	3.2 million	March 2, 2032
\$1.6 billion of cumulative revenue generated by the sales platform up to the expiry date	4.2 million	March 2, 2034

The contingent consideration will be recognized as additional purchase consideration for the intangible asset, if and when the obliging events occur (Note 10).

The total initial purchase consideration was \$21.5 million, based on the closing price of the Company's common shares on the acquisition date, plus transaction costs and other adjustments of \$0.4 million. The Company concluded that the acquired assets and assumed liabilities of Clara did not constitute a business and accordingly, the transaction was accounted for as an asset acquisition. The consideration paid was allocated entirely to the intangible assets (Note 10).

10. INTANGIBLE ASSETS

	2018
Balance, beginning of year	\$ -
Acquisition of intangible assets (Note 9)	21,868
Development expenditures	1,139
Translation differences	(1,209)
Balance, December 31, 2018	\$ 21,798

Proceeds from the first sale on the Company's digital platform, Clara, were recorded to development expenditures as preproduction revenue of \$0.7 million during the year ended December 31, 2018.

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11. RESTORATION PROVISIONS

The Company's restoration provisions relate to the rehabilitation of the Karowe Diamond Mine in Botswana. The provisions have been calculated based on total estimated rehabilitation costs and discounted back to their present values. The pre-tax discount rates and inflation rates are adjusted annually and reflect current market assessments. The Company has applied a pre-tax discount rate of 10.4% at December 31, 2018 (2017 - 8.4%) and an inflation rate of 3.95% at December 31, 2018 (2017 - 3.3%). Rehabilitation costs at the Karowe Diamond Mine are expected to commence during 2023 and continue through 2024. The estimated liability for reclamation and remediation costs on an undiscounted basis is approximately \$25.7 million (2017 - \$24.1 million).

		2018		2017
Balance, beginning of year	\$	18,941	\$	15,679
Changes in rates and estimates		724		275
Accretion of liability component of obligation		2,220		1,511
Foreign currency translation adjustment		(1,701)		1,476
Long-term portion of restoration provisions	\$	20,184	\$	18,941

12. SHARE BASED COMPENSATION**a. Stock options**

The Company's stock option plan (the 'Option Plan') was approved by the shareholders of the Company on May 13, 2015. Under the terms of the Option Plan, a maximum of 20,000,000 shares are reserved for issuance upon the exercise of stock options. The Option Plan provides the Board of Directors with discretion to determine the vesting period for each stock option grant. Options typically vest in thirds over a three-year period, beginning 12 months from the date of grant.

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 (CA\$)
Balance at December 31, 2016	3,346,670	\$ 2.39
Granted	910,000	2.78
Exercised ⁽¹⁾	(373,333)	2.27
Forfeited	(145,000)	2.75
Balance at December 31, 2017	3,738,337	2.48
Granted	1,490,000	2.36
Exercised ⁽¹⁾	(200,000)	2.15
Forfeited	(750,001)	2.79
Balance at December 31, 2018	4,278,336	\$ 2.40

(1) The weighted average share price on the exercise dates for the 2018 stock option exercises was CA\$2.18 (2017: CA\$2.97).

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12. SHARE BASED COMPENSATION (continued)

Options to acquire common shares have been granted and are outstanding at December 31, 2018 as follows:

Outstanding Options				Exercisable Options			
Range of exercise prices CA\$	Number of options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price CA\$	Number of options exercisable	Weighted average remaining contractual life (years)	Weighted average exercise price CA\$	
\$1.50 - \$2.00	33,334	0.64	\$ 1.80	33,334	0.64	\$ 1.80	
\$2.01 - \$2.50	3,710,002	1.79	2.35	1,783,340	0.84	2.33	
\$2.51 - \$3.00	535,000	2.23	2.77	178,334	2.23	2.77	
	4,278,336	1.84	\$ 2.40	1,995,008	0.96	\$ 2.36	

During the year ended December 31, 2018, an amount of \$0.5 million (2017 – \$0.7 million) 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:

	2018	2017
Assumptions:		
Risk-free interest rate (%)	2.03	1.02
Expected life (years)	2.48	3.63
Expected volatility (%)	39.21	41.78
Expected dividend	CA\$0.025/share quarterly	CA\$0.025/share quarterly
Results:		
Weighted average fair value of options granted (<i>per option</i>)	CA\$ 0.50	CA\$ 0.69

b. Share units

The Company has a share unit ('SU') plan that provides for the issuance of SUs as a long-term incentive for certain members of the management team. SUs vest three years from the date of grant. Each SU entitles the holder to receive one common share and the cumulative dividend equivalent SU earned during the SU's vesting period. The value of each SU at the vesting date is equal to the closing value of one Lucara common share plus the cumulative dividend equivalent which was earned over the vesting period.

For the year ended December 31, 2018, the Company recognized a share-based payment charge against income of \$1.0 million (2017: \$0.8 million) for the SUs granted during the year.

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12. SHARE BASED COMPENSATION (continued)

	Number of shares issuable pursuant to share units	Weighted average price per share (CA\$)
Balance at December 31, 2016	1,067,493	\$ 2.46
March 8, 2017 grant	283,500	2.75
March 30, 2017 dividend	10,924	3.09
June 15, 2017 dividend	12,110	2.81
September 14, 2017 dividend	14,015	2.45
December 14, 2017 dividend	13,548	2.56
Balance at December 31, 2017	1,401,590	2.53
February 27, 2018 grant	364,000	2.36
April 2, 2018 grant	125,000	2.05
April 12, 2018 dividend	21,213	2.08
May 14, 2018 vesting	(490,661)	2.07
May 31, 2018 vesting	(327,049)	2.56
June 21, 2018 dividend	12,601	2.17
June 29, 2018 grant	140,000	2.11
September 20, 2018 dividend	13,848	2.25
December 20, 2018 dividend	22,503	1.40
Balance at December 31, 2018	1,283,045	\$ 2.54

13. PRINCIPAL SUBSIDIARIES

The Company had the following subsidiaries at December 31, 2018 and 2017:

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

(1) Intermediate holding company

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

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14. ADMINISTRATION

	2018	2017
Salaries and benefits	\$ 5,796	\$ 4,989
Severance	2,343	-
Professional fees	1,549	2,596
Office and general	1,458	1,776
Marketing	1,077	1,523
Stock exchange, transfer agent, shareholder communication	397	410
Travel	1,082	933
Stock based compensation (Note 12)	1,447	1,484
Management fees	461	407
Depreciation	426	606
Donations	355	510
	\$ 16,391	\$ 15,234

15. INCOME TAXES

	2018	2017
Current	\$ 5,857	\$ 14,841
Deferred	6,688	17,261
Income tax expense	\$ 12,545	\$ 32,102

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

	2018	2017
Statutory tax rate	27.00%	26.00%
Net income before tax	24,197	97,219
Computed income tax expense	6,533	25,277
Differences between Canadian and foreign tax rates	(1,564)	(4,251)
Non-deductible expenses and other permanent differences	888	573
Deferred tax effect of Botswana variable tax rate in excess of Botswana standard tax rate	1,225	6,162
Change in deferred benefits not recognized	2,190	1,992
Exchange rate differences	876	(269)
Withholding taxes	2,397	2,618
	\$ 12,545	\$ 32,102

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

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15. INCOME TAXES (continued)

The Company has not recognized deferred tax liabilities in respect of historical unremitted earnings from foreign subsidiaries for which the Company is able to control the timing of the remittance and which are considered by the Company to be reinvested for the foreseeable future. At December 31, 2018, these earnings amount to \$122.5million (2017: \$154.3 million). All of these earnings would be subject to withholding taxes if they were remitted by the foreign subsidiaries.

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

		2018		2017
Balance, beginning of year	\$	72,919	\$	50,516
Deferred income tax (recovery) expense		6,688		17,261
Foreign currency translation adjustment		(6,125)		5,142
Balance, end of year	\$	73,482	\$	72,919
Deferred income tax assets and liabilities recognized		2018		2017
<i>Deferred income tax assets</i>				
Non-capital losses	\$	300	\$	384
Accounts payable and other		861		-
Unrealized foreign exchange loss		680		1,673
Restoration provisions		6,780		6,515
Total deferred income tax assets		8,621		8,572
<i>Deferred income tax liabilities</i>				
Mineral properties, plant and equipment		79,814		79,219
Future withholding taxes		2,289		2,280
Other		-		(8)
Deferred income tax liabilities		82,103		81,491
Deferred income tax liabilities, net	\$	73,482	\$	72,919
Deferred income tax assets not recognized		2018		2017
Tax losses	\$	20,393	\$	21,166
Mineral property, plant and equipment		40		43
Other deductible temporary differences		263		27
	\$	20,696	\$	21,236

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15. INCOME TAXES (continued)

As at December 31, 2018, the Company has non-capital losses for income tax purposes which expire as follows:

	2019	2020	2021	Subsequent to 2022	No expiry date	Total
Canada	\$ -	\$ -	\$ -	\$ 68,211	\$ -	\$ 68,211
United Kingdom	-	-	-	-	3,613	3,613
	\$ -	\$ -	\$ -	\$ 68,211	\$ 3,613	\$ 71,824

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

16. INCOME PER COMMON SHARE**a) Basic**

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

	2018	2017
Income for the year	\$ 11,652	\$ 65,117
Weighted average number of common shares outstanding	394,008,955	382,619,294
	\$ 0.03	\$ 0.17

b) Diluted

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

	2018	2017
Income for the year	\$ 11,652	\$ 65,117
Weighted average number of common shares outstanding	394,008,955	382,619,294
Adjustment for stock options	5,070	139,044
Adjustment for share units	1,395,735	1,314,472
Weighted average number of common shares for diluted earnings per share	395,409,760	384,072,810
	\$ 0.03	\$ 0.17

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17. GAIN ON CONTRACTOR SETTLEMENT

In Q4 2017, the Company settled its performance dispute with a previous mining contractor and realized a net gain on the settlement of \$7.0 million. The net gain arises as a result of the reversal of a trade payable accrual for the cost of mining services invoiced by the previous mining contractor relating to the years 2015 and 2016. The dispute is now closed.

18. RELATED PARTY TRANSACTIONS

Key management compensation

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

	2018	2017
Salaries and wages	\$ 2,759	\$ 2,662
Severance	2,343	-
Short term benefits	255	159
Stock based compensation	1,208	1,164
	<u>\$ 6,565</u>	<u>\$ 3,985</u>

a) Clara acquisition

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

Pursuant to the profit sharing mechanism described in Note 9, a total of 3.45% of the EBITDA generated by the platform has been assigned to two directors of Lucara, each of whom was a founder of Clara. A further 3.22% of the EBITDA generated by the platform may be distributed to members of management, at the discretion of Lucara's Compensation Committee, based on the achievement of key performance targets.

b) Other related parties

For the year ended December 31, 2018, the Company paid \$0.4 million (2017: \$0.4 million) to a charitable foundation directed by certain of the Company's directors to carry out social programs on behalf of the Company in Botswana. For the year ended December 31, 2018, the Company paid \$0.5 million (2017: \$0.4 million) to a management company directed by certain of the Company's directors for office space and office management services.

LUCARA DIAMOND CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

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19. SEGMENT INFORMATION

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

2018			
	Karowe Mine	Corporate and other	Total
Revenues ⁽¹⁾	\$ 176,191	\$ -	\$ 176,191
Income from mining operations	51,509	(73)	51,436
Exploration expenditures	(3,359)	-	(3,359)
Finance income (expenses)	(2,183)	(369)	(2,552)
Foreign exchange (loss) / gain	(2,449)	111	(2,338)
Other	(6,873)	(12,117)	(18,990)
Taxes	(12,131)	(414)	(12,545)
Net income (loss) for the year	24,514	(12,862)	11,652
Capital expenditures	(58,820)	(1,881)	(60,701)
Total assets	342,186	28,709	370,895
2017			
	Karowe Mine	Corporate and other	Total
Revenues ⁽¹⁾	\$ 220,763	\$ -	\$ 220,763
Income from mining operations	121,589	(115)	121,474
Exploration expenditures	(4,754)	-	(4,754)
Finance income (expenses)	(1,138)	(1,220)	(2,358)
Foreign exchange loss	(4,953)	(699)	(5,652)
Other expenses	495	(11,986)	(11,491)
Taxes	(31,343)	(759)	(32,102)
Net income (loss) for the year	79,896	(14,779)	65,117
Capital expenditures	(60,179)	-	(60,179)
Total assets	357,072	8,738	365,810

⁽¹⁾ During the year ended December 31, 2018, no customers generated more than 10% of the Company's total revenue. During the year ended December 31, 2017, one customer generated more than 10% of the Company's total revenue, representing 27% of the Company's 2017 revenue.

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

Plant and equipment		Mineral properties		Other	
2018	2017	2018	2017	2018	2017
Canada	\$ -	\$ 11	\$ -	\$ 21,830	\$ 145
Botswana	147,246	167,565	113,109	90,559	3,706
	\$ 147,246	\$ 167,576	\$ 113,109	\$ 90,559	\$ 25,536
					\$ 4,261

All depletion and amortization expense relates to the assets at the Karowe Mine located in Botswana.

LUCARA DIAMOND CORP.

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20. FINANCIAL INSTRUMENTS

a) *Measurement categories and fair values*

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

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

b) *Fair value hierarchy*

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

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

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

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

	December 31, 2018	December 31, 2017
Level 1: Fair value through other comprehensive income – Investments	\$ 920	\$ 2,318
Level 2: Fair value through profit and loss – Investments	\$ -	\$ 182
Level 3: N/A		

c) *Financial risk management*

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

Currency risk

The Company is exposed to the financial risk related to fluctuating foreign exchange rates. All sales revenues are denominated in U.S. dollars, while directly related costs are denominated in Botswana Pula. At December 31, 2018, the Company is exposed to currency risk relating to U.S. dollar cash held within its subsidiaries with Canadian or Pula functional currency. Based on this exposure, a 10% change in the U.S. dollar exchange rate would give rise to an increase/decrease of approximately \$1.6 million in net income for the year.

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 and cash equivalents are held through a large Canadian financial institution with a high investment grade rating. Considering the nature of the Company's ultimate customers and the relevant terms and conditions entered into with such customers, the Company believes that credit risk is limited as goods are not released until full payment is received.

LUCARA DIAMOND CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

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

20. FINANCIAL INSTRUMENTS (continued)

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

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 the head office. Rolling forecasts of the Company's liquidity requirements are monitored to ensure it has sufficient cash to meet operational needs at all times. Such forecasting takes into consideration the Company's debt financing plans.

Revolving credit facility

The Company holds a \$50 million revolving term credit facility with the Bank of Nova Scotia which was renewed in Q2 2017 for a three year period and 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, 2018, 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 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, 2018, \$10.0 million was drawn on the facility for working capital purposes (2017 - \$nil). The current interest rate on the amount drawn is LIBOR plus a margin of 2.75%. The remaining \$40.0 million under this facility was available and undrawn at December 31, 2018.

21. CAPITAL MANAGEMENT

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

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

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

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