DIAMONDS IN CANADA

JUNE | 2017

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KENNADY PROVES UP POTENTIAL

THE NORTHERN MINER
GLOBAL MINING NEWS · SINCE 1915

Complimentary
PM no. 40069240

DIAMONDS

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JUNE 2017

ON THE COVER:
North Arrow Minerals geologist Art Kidston at the Naujaat project in Nunavut.
Credit: North Arrow Minerals

Digital copy available to subscribers at www.northernminer.com

THE NORTHERN MINER

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Printed in Canada.

Issue price: $6.00

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“Dominion Diamond, Canada’s largest producer and the world’s third largest diamond miner, may fall out of Canadian hands.”

A changing landscape

Outside of the two new mines opening up in Canada — Stornoway Diamond’s Renard and De Beers and Mountain Province Diamonds’ Gahcho Kué — there hasn’t been a lot to celebrate in the diamond world of late.

In Canada, De Beers flooded its Snap Lake mine in the Northwest Territories in January. The underground mine, which has never been profitable, had been put up for sale after being put on care and maintenance last April, but failed to find a buyer. The mine was the diamond giant’s first mine outside of Africa when it opened in 2008. In Ontario, De Beers has put an expansion of its Victor mine on hold after failing to get the support of the nearby Attawapiskat First Nation to conduct a bulk sample at the Tango kimberlite. Production from the mine is slated to end in 2018, but De Beers is studying ways to delay closing Victor by processing lower-grade stockpiles or mining deeper into the pit. It’s also considering a sale of the asset.

Meanwhile, Dominion Diamond, Canada’s largest producer and the world’s third largest diamond miner, may fall out of Canadian hands. Dominion was approached by U.S.-based Washington Corps. in February, although a formal offer wasn’t received at the time. The approach put Dominion in play, and in early May, the company reported that it had signed confidentiality agreements with interested parties including Washington Corps. in return for access to its data room. To compound its uncertain situation, the company is in the middle of a change of leadership. It’s been searching for a new president and CEO since Brendan Bell announced his resignation in January.

And it’s been far from smooth sailing in diamond market, even with a healthy increase in rough prices last year. In November, there was a big shock to the market when India’s government suddenly invalidated all 500 and 1,000 rupee notes — 86% of all the currency in circulation. The demonetization decimated demand for smaller and lower-quality diamonds, forcing diamond miners to hold back or withdraw their smaller and lower-quality goods from sale.

But the Indian economy has remained surprisingly strong. Despite the move, India’s growth reached 7% in the last quarter of 2016 — outstripping expectations of 6.1-6.4% growth. That could mean the effect on diamond prices will be relatively short-lived, and indeed, there are early signs that India’s economy is already normalizing.

If De Beers’ sales are any sign, the market for lower-value goods is already recovering. In its first quarter, the diamond miner sold 14.1 million carats of diamonds, up 74% from the same period a year earlier. While some of the increase was due to its holding three sales during the quarter compared with two in the same quarter of 2016, the sales allowed the miner to sell lower-value inventory it couldn’t sell late last year due to lower demand.

We don’t know how all this turmoil in the diamond world will end, and it may be a very different landscape when we see you again for our November issue. But here’s hoping we’ll have more reason than ever to celebrate Canada’s diamond sector.

As ever, we welcome your feedback at ahiyate@northernminer.com


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Q&A

BMO's Ed Sterck talks demonetization and diamond equities

A rough stone from Stornoway Diamond's Renard mine in Quebec.
Credit: Stornoway Diamond

BY SALMA TARIKH

In late 2016 and early 2017 the diamond market felt the effects of India's demonetization, which saw 500-rupee and 1,000-rupee bills suddenly removed from the market last November. The move impacted India's cottage cutting and polishing industry, a mainly cash business responsible for refining half of the world's diamonds by volume or roughly 10% by value.

In an April interview with *Northern Miner* staff writer Salma Tarikh, Edward Sterck, Director of Equity Research, Metals and Mining at BMO Capital Markets, notes there are signs that the Indian currency reform, which started last November, is normalizing. The London-based analyst also explains why he expects higher rough prices following 2017, and shares his outlook on several diamond producers.

Lucara Diamond's Karowe mine in Botswana.
Credit: Lucara Diamond

Diamonds in Canada: Rough diamond prices overall performed better in 2016 than they did in 2015. Where do you see prices heading this year and beyond?

Edward Sterck: This year we have a flat diamond price outlook, and part of that is just reflecting a little bit of uncertainty as to whether the Indian currency situation is really resolved or not. Then for 2018 and '19, we have got 6.5% per annum price inflation in our estimates and then flat thereafter. That just reflects my forecast of a little bit of mine supply increase this year as you have got **Stornoway Diamond**'s (TSX: SWY) Renard operation continuing to ramp up, **Mountain Province Diamond** (TSX: MPV; NASDAQ: MPVD) and **De Beers**' Gahcho Kué operation completing its ramp up and then some production increases out of **Dominion Diamond** (TSX: DDC; NYSE: DDC) and **Petra Diamonds** (LSE: PDL).

But over the mid-to-longer term, we think diamond production has peaked, and at best we'd expect to see diamond production plateau at these levels. But depletion of the big operations in Botswana and Russia could result in production coming off slightly over the coming years.

DiC: Will the additional supply by the new producers impact the prices of smaller and lower-quality rough diamonds already hit by the Indian currency issue?

ES: Based on the pre-production independent diamond valuations, the overall product mix coming out of those mines is expected to be on average slightly better than the global average. So they won't be contributing just to the lower end of the spectrum, it will be rather across the board with an average being slightly higher than the global average diamond prices.

For Renard and Gahcho Kué, Indian demonization has been an issue because with initial auctions for a new production centre, diamantaires tend to very cautious about the goods that come out. They don't know how those goods are going to cut and polish, so they make their initial bids accordingly to reflect that uncertainty.

But the overall production increase from those operations isn't really significant enough to exacerbate the Indian demonetization situation.

DiC: What would be the biggest near-term risks facing the diamond market?

ES: Indian demonetization is still there. I think it's resolvable, but the timeframe in which that happens is uncertain. All I can say is that the indications are at the moment that it is being fixed. Then I think it mainly comes down to the economic trajectory that the global economy is taking. So, if we are in the recovery part of the cycle, everything looks pretty good for diamonds going forward. And if people are actually still a bit nervous then they may postpone making jewelry purchases that they were otherwise planning to make, then that would be a negative.

DiC: Following an unsolicited US$1.1-billion bid from Washington Companies, Dominion Diamond recently formed a special committee to assess potential alternatives, including a possible sale of the company. You noted that the offer potentially underpriced the stock, which recently had fallen due to difficulties at the Ekati mine and the Indian demonetization. What would have been a fair price for the stock?

ES: The value really depends upon where we are in the cycle. Diamond stocks and valuation multiples applied are very, very cyclical. So if they are at bottom of the cycle, they might be priced around 0.4x NPV and at the top it could be 1.3x or even high as 1.5x NPV. The diamond cycle is linked to but somewhat independent of the global economic cycles. If we feel like we are coming out of the bottom of a cycle, then maybe higher multiples would be appropriate for a transaction. If we take a view that we are actually in the trough and should be there a little longer, than maybe lower multiples would be appropriate. As things stand for me right now, with the caveat that I'm not an economist, it appears that we are probably in the recovery part of the cycle, maybe a more drawn out and protracted recovery than we have seen in previous cycles. Therefore maybe higher multiples somewhere around just about the middle of that range that I've given would be more appropriate. From an overall perspective, diamonds do tend to be quite a late-cycle commodity.

My target price for Dominion at the moment is $20. I think

Sorting diamonds at the Gahcho Kué mine in the Northwest Territories.
Credit: Mountain Province Diamonds

that is probably about as much as I'll be prepared to be drawn on that right now.

DiC: Can you talk a bit about which companies may be interested in Dominion and the different alternatives Dominion might explore?

ES: There are various scenarios that one could come up with. Firstly, there could be some kind of merger with another diamond company. Is that necessarily a takeout situation that generates an immediate liquidity event for shareholders? Not particularly. That said, overall liquidity would probably be increased, so maybe that would be a positive.

When BHP was originally selling Ekati, press reports at the time suggested that private equity groups were interested. Perhaps it is reasonable to assume that they might be again now.

Then finally, one could potentially see **Rio Tinto** (NYSE: RIO; LSE: RIO) being interested. They are the operator of Diavik and maybe there are some synergies in combining the two operations.

As things stand, Rio Tinto's two diamond businesses — Diavik and Argyle — are both expected to end in some point in the early to mid-2020s. If Rio Tinto wanted to maintain its diamond business, then maybe there are opportunities to do that through combining Diavik and Ekati.

That said, I think there are some optical challenges to that. Principally, Rio Tinto is coming out of a period where it has been shedding assets. They have begun to talk about some M&A opportunities or M&A desires, which would be a better way to put it. But the entire focus to date so far has been on copper.

So for Rio Tinto to spend whatever the cost is to buy Dominion, which would probably be a bit more than a billion dollars, it might be optically a bit challenging to get across to the shareholders unless they can put forward a very tangible solid rationale.

DiC: Do you see Rio Tinto potentially selling its stake in Diavik and altogether exiting the diamond sector?

ES: It is quite possible. That is the other side of the equation rather than trying to keep it going, maybe, they would be prepared to sell. I think one of the challenges for Rio Tinto — bearing in mind that they ran a review of the diamond business a couple years ago — is that they have to have confidence that if they were to sell, whoever they sell to would be good stewards of the legacy.

DiC: You recently upgraded **Lucara Diamond** (TSX: LUC) to outperform while maintaining your target price at $3.50. You noted that the stock is expensive versus peers but that the potential for the company to sell its 1,109-carat Lesedi la Rona diamond and to recover other large stones calls for a premium. What's the best avenue the company can pursue to get the most value for the diamond? When do you believe a potential sale will happen?

ES: That is one of the things that's very difficult to judge — the timing of it. They tried to sell it via an auction with Sotheby's but that didn't work for whatever reason. I guess that there are other avenues that they could pursue: selling it as part of their regular special diamond tenders, or selling it directly to a diamantaire or private individual. Or maybe they could look to enter into some kind of beneficiation agreement, where they perhaps sell the rough for a little bit less than they would otherwise, but they retain an interest in the resale value of the polished goods.

DiC: You're forecasting the diamond would go for US$75 million.

ES: Well, we have to pick a number. The reality is I'm not in the position to really look at the diamond and say this is how much it is worth. They sold a 813-carat diamond previously and that had a sale value at or above US$63 million.

DiC: Stornoway Diamond reached commercial production at its Renard mine last December. You currently have an outperform rating with a $1.25 target on the stock, which is trading around 82¢. Why is there a gap between your valuation and the trading price?

ES: The stock has taken a bit of a hit after the first sale. Firstly, they were impacted by Indian demonetization. In their first auction, a number of their goods were held back from sale because they felt the pricing offered wasn't adequate and assuming the normalization of Indian demonetization, that they will get better prices in the future. We have to wait for the results of further auctions to see if that is the case or not.

The second factor is that they've been getting some breakage in the plant. Now that isn't an unusual situation with a new diamond plant starting up. It isn't unusual to have some processing issues in the plant of any commodity on startup.

Stornoway has brought in experts in minimizing diamond breakage and they have identified the areas in the plant where they feel that breakage is occurring. So, they have a remedial plan to try to resolve that situation. Now the potential for them to achieve that I think is pretty good. I would expect them to fix that situation and for that to ultimately result in higher realized diamond prices.

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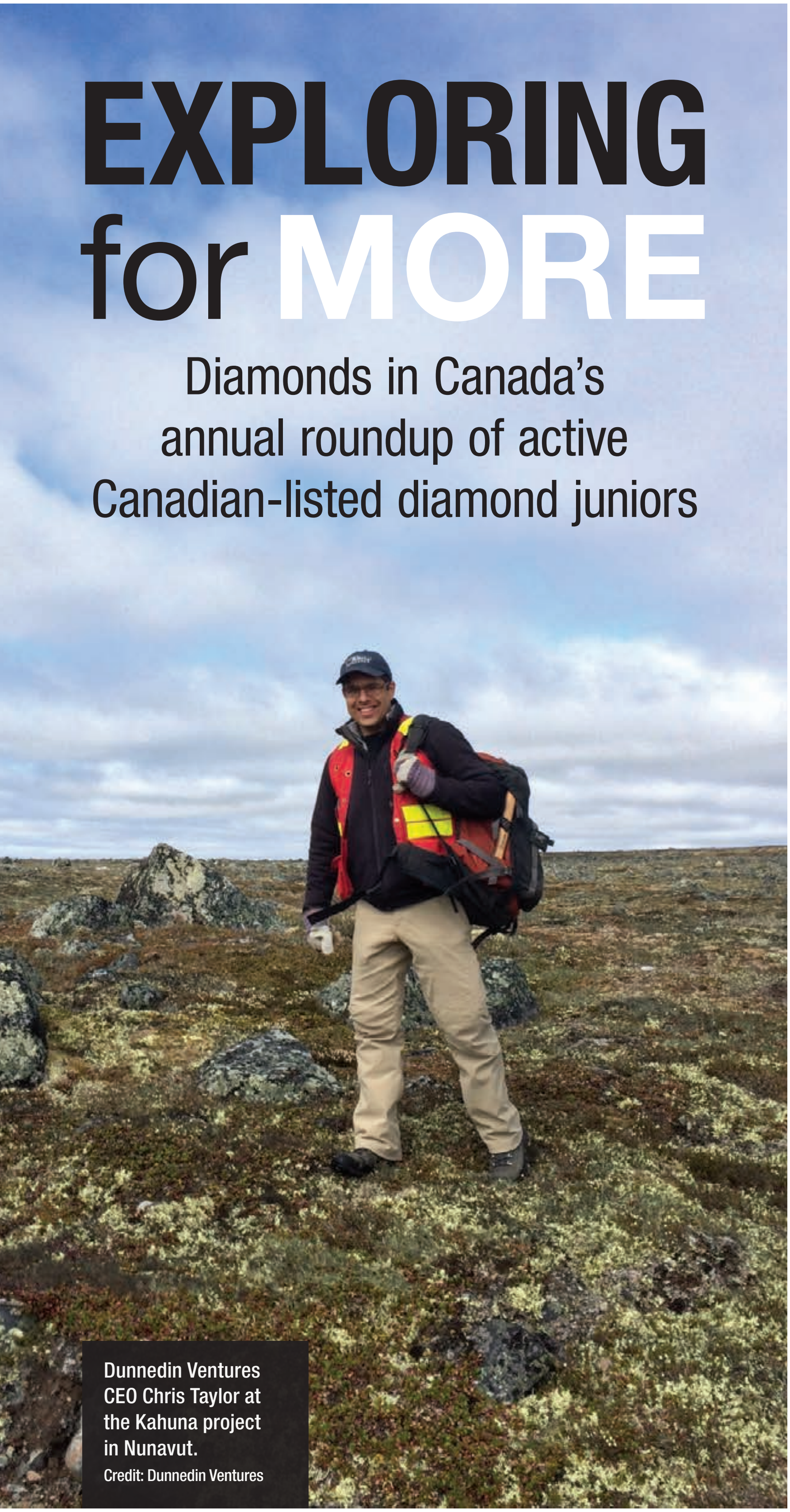
Diamonds in Canada's annual roundup of active Canadian-listed diamond juniors



Dunnedin Ventures CEO Chris Taylor at the Kahuna project in Nunavut.
Credit: Dunnedin Ventures

Alto Ventures

In February, Alto Ventures began a reverse-circulation drilling program to test several kimberlite targets at the GEFA project, in east-central Saskatchewan. The targets were identified in 2015 through a high-resolution aeromagnetic survey. Alto is earning a 60% interest in the claims from **North Arrow Minerals** by completing $750,000 in exploration and paying $60,000 in cash by July 20, 2017. It's already completed $515,000 in exploration and made a $25,000 payment. GEFA is adjacent to North Arrow's Pikoo project.

Arctic Star Exploration (TSXV: ADD)

In July, Arctic Star acquired the Diamond Dunes project in Saskatchewan's western Athabasca Basin. The project consists of two separate claim blocks southwest and southeast of **CanAlaska Uranium**'s Athabasca diamond project.

CanAlaska Uranium (TSXV: CVV)

Although **De Beers** dropped its option to earn up to 90% of CanAlaska Uranium's claims in northern Saskatchewan in December, the junior in March said it had begun lining up other potential exploration partners.

Drilling by De Beers of seven magnetic targets in September 2016 intercepted magnetic material in the organic overburden, followed by unconsolidated sand and boulders, and then sandstone. However, CanAlaska says that the magnetic material cannot explain all the targets.

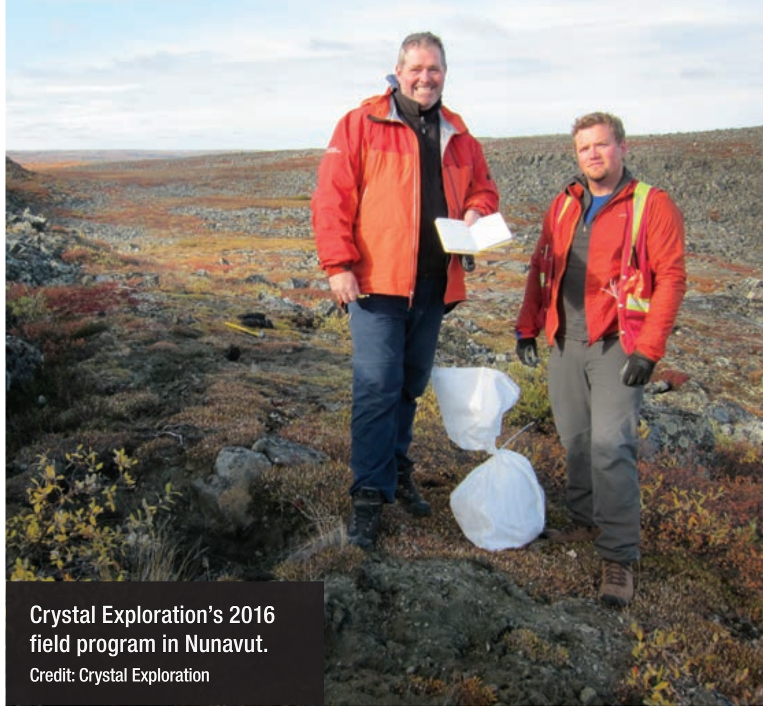
CanAlaska initially announced it had staked claims containing 75 kimberlite targets in the western Athabasca basin in February 2016.

Primarily a uranium explorer, the company also reported it has flown 40% of its diamond property in Alberta with a low-level, closely spaced magnetic survey and was modelling 30 of the targets.

Canterra Minerals (TSXV: CTM)

Last summer, Canterra Minerals completed a 1,770 line-km airborne magnetic survey at the West Carswell property in Saskatchewan, where it earning up to a 70% interest from **CanAlaska Uranium**. The proect, 20 km southwest of CanAlaska's Athabasca diamond project, contains six discrete magnetic anomalies, identified through a 2011 suvey by the Saskatchewan Geological Survey.

Sampling at CanAlaska Uranium's Athabasca project in Saskatchewan.
Credit: CanAlaska Uranium



Crystal Exploration's 2016 field program in Nunavut.
Credit: Crystal Exploration

Crystal Exploration (TSXV: CEI)

Crystal Exploration is planning a three-phase exploration program for its Muskox, Contwoyto and Hood projects in Nunavut, near the past-producing Jericho mine. The program, focused on finding new kimberlites, will consist of ground geophysics, till sampling and drilling. Crystal already has five magnetic high targets and one magnetic low target to investigate.

Crystal agreed to purchase the Contwoyto project from **North Arrow Minerals** in March.

The junior has processed existing drill core from Muskox totalling 22.4 tonnes of magmatic kimberlite and 14.3 tonnes of pyroclastic kimberlite, grading 0.45 carat per tonne and 0.19 carat per tonne, respectively. The company noted that the sample size was small and further work is needed to understand the pipe, which is almost 4 hectares at surface and extends to more than 300 metres depth.

Crystal closed a $312,000 financing in December.

Dunnedin Ventures (TSXV: DVI)

In March, the Nunavut Impact Review Board recommended the federal government approve Dunnedin Ventures' proposed driling and bulk sampling program at its Kahuna project in Nunavut. The program will test high-priority targets and allow the junior to collect a 1,000-carat parcel of diamonds for valuation.

A recent 0.144-tonne sample taken by Dunnedin from Kahuna returned 13 commercial-sized stones weighing 0.334 carat for a grade of 2.32 carats per tonne.

Dunnedin has also sampled the Notch kimberlite, with 2.36 tonnes of kimberlite returning 2.38 carats of commercial-size diamonds for a grade of 1.01 carats per tonne.

Dunnedin commissioned a maiden resource on the project in 2015, based on previous drilling. The Kahuna and Notch kimberlites contain combined inferred resources of 4 million carats at an average grade of 1.01 carats per tonne. The company raised $1.1 million in January.

Five Star Diamonds (TSXV: STAR)

Newly listed Five Star Diamonds is aiming to be one of the first diamond producers in Brazil focused on kimberlite rather than alluvial mining. An initial mining and pilot processing program has already been completed at three diamond-bearing kimberlites at its Catalao project, in Goias state. A feasibility study is expected to be complete by the end of June.

Five Star also has 21 other projects totalling 1,200 sq. km that host 15 diamond-bearing kimberlites and 87 kimberlites that haven't yet been tested.

GGL Resources (TSXV: GGL)

GGL Resources announced early this year that it was in talks regarding a corporate transaction with a private company in order to raise money and advance its portfolio of properties in the Northwest Territories. The private company also has exploration and development stage assets in the territory.

Margaret Lake Diamonds (TSXV: DIA)

As of November, Margaret Lake Diamonds had earned a 60% interest in a 187 sq.-km portion of **Arctic Star Exploration**'s T-Rex property, in the Northwest Territories. Margaret Lake is now the operator of the "Diagras" project, which lies along the north-northeast part of the Lac de Gras kimberlite field in a tight corridor of economic kimberlites. Inspired by the success of **Kennady Diamonds**, the JV will revisit 13 known kimberlites on the Diagras property. Ground geophysical work was expected to begin in the spring.

The company also holds 100% of the Margaret Lake property just north of the Gahcho Kué mine and the Kennady North project. Margaret Lake raised $785,000 in October.

North Arrow Minerals (TSXV: NAR)

North Arrow now holds 100% of the Naujaat (formerly Qilalugaq) and Pikoo projects, having acquired the remaining 18% and 15% stakes from **Stornoway Diamond** in February. Work in 2017 at Naujaat will include a 4,000 to 6,000-metre drill program at the Q1-4 kimberlite to confirm grade and tonnage down to 300 metres depth. The kimberlite contains inferred resources to 205 metres depth totalling 48.8 million tonnes grading 53.6 carats per hundred tonnes for 26.1 million carats.

The company is also planning to collect a bulk sample of 300 dry tonnes this year from Q1-4, which should yield close

At Peregrine Diamonds' Chidliak project in Nunavut.
Credit: Peregrine Diamonds

Tsodilo Resources geophysicist Macdonald Kahari.
Credit: Tsodilo Resources

to 180 carats. Q1-4 contains a population of fancy orangey-yellow diamonds.

At Pikoo in Saskatchewan, where it has so far discovered 10 kimberlites, North Arrow will conduct ground geophysics and till sampling this year.

In September, the junior decided not to complete an option to earn up to 55% of the Redemption project from **Arctic Star Exploration** by spending $5 million on exploration. Over the past three years, North Arrow spent about $4 million on the project, located in the Lac de Gras kimberlite field.

North Arrow was unable to find a kimberlite bedrock source for the Coppermine indicator mineral train, with most of the geophysical targets tested proving to be granitoid intrusive units or variable metasedimentary rocks.

However, the junior did retain a 55% interest in one of the Redemption claims, and identified new target areas south and east of Redemption on claims it has named "Loki." The company recently received a drill permit for the project, where till sampling has identified several potential kimberlite targets at Loki South. Loki East contains the diamondiferous EG05 kimberlite.

Dominion Diamond has started a $2.8-million exploration program at the LDG joint venture just east of Loki. North Arrow's interest in LDG will be diluted to 31% as it will not be funding its share of the program in order to focus on other projects.

Pangolin Diamonds (TSXV: PAN)

Soil sampling at Pangolin Diamonds' Malatswae project in Botswana has turned up three new diamonds, bringing the total found to 16 stones measuring 0.5 mm or more. Pangolin reports that the diamonds, which include a clear, white stone measuring 2-mm by 2-mm by 2-mm, have been found in six geologically different zones at the project.

The company is also completing detailed ground magnetic surveys in select areas at Malatswae, and soil sampling programs at its Moenyenana, Jwaneng South, Machaneng South projects in Botswana.

Peregrine Diamonds (TSX: PGD)

Peregrine Diamonds will launch a drill program in June to define underground resources at its CH-6 kimberlite, at the Chidliak project in Nunavut.

An internal concept study of a potential open-pit and underground development of CH-6 has concluded the economics of the project could be enhanced by adding an underground development to mine CH-6 below 260 metres depth, the current bottom of the resource. CH-6 holds inferred open-pit resources of 11.39 million carats in 4.64 million tonnes grading 2.45 carats per tonne.

The drill program will focus on expanding resources at CH-6 up to 500 metres depth. Peregrine will also continue to refine the geotechnical design parameters of the open pit and on advancing permitting.

Last August, Peregrine released a preliminary economic assessment (PEA) outlining positive economics for an open-pit development scenario for the CH-6 and CH-7 kimberlites. The study estimated that with a preproduction capex of $434.9 million, including $56.7 million in contingencies, and a discount rate of 7.5%, the project has an after-tax net present value of $471.2 million and an internal rate of return of 29.8%. The development is envisioned as the first phase of a potentially larger operation at Chidliak.

Till sample drop off and refuelling location at North Arrow Minerals' Mel project in Nunavut.
Credit: North Arrow Minerals

The study pegged production at an average of 1.2 million carats per year over a 10-year mine life. The payback period was estimated at two years and the operating margin at 72%.

Rockwell Diamonds (TSX: RDI; JSE: RDI)

Trading in South Africa-focused alluvial miner Rockwell Diamonds was suspended in late March, after an interim liquidation order was placed against three of Rockwell's subsidaries by a mining contractor that claims it is owed money. A hearing is scheduled for June 22.

The company has completed commissioning at its Wouterspan plant, which recently recovered a 60-carat diamond that sold for US$8,000 per carat.

Shore Gold (TSX: SGF)

In March, Shore Gold reported progress towards an updated feasibility study at its Star-Orion South project in Saskatchewan. The work is focused on looking at new technology for efficient open-pit mining; improving the flow sheet of the processing plant; and reducing preproduction capital costs and time required to get to initial production.

It has completed work on X-ray Transmission (XRT) recovery of diamonds from pyroclastic kimberlite at Star, a review of ore processing data, characterization of diamond parcels, analysis of kimberlite particle size, and overburden removal investigations.

Shore received notice from the province's Environment Ministry in January that it is entering additional consultations with First Nations and Métis communities that should be complete within six months. After that, the ministry will make a decision regarding approval of the project's environmental impact statement.

Tango Mining (TSXV: TGV)

Tango Mining was unable to close a US$30-million loan last year to acquire the past-producing BK11 project in Botswana from **Firestone Diamonds**. But it still has a stake in the Oena alluvial diamond project in South Africa's Northern Cape province.

In a one-month period ending March 20, 183 diamonds weighing a total of 307.94 carats were recovered from reprocessed tailings at Oena, and sold at an average price of US$1,330 per carat. During test commissioning, a 36.34-carat diamond was recovered and sold for US$6,054 per carat.

Subject to regulatory approvals, the company has sold 8% of African Star Minerals, which holds 100% of Oena, to Georges Zard of the GZA Group. The transaction is subject to the renewal of the mining licence for Oena, which is pending. Tango held a 51% interest in African Star before the transaction.

Separately, Zard has acquired a 23% interest in African Star from a director of the company for a total stake of 31%.

Tsodilo Resources (TSXV: TSD)

In preparation for a large-diameter drilling (LDD) program, Tsodilo Resources began a 3,000-metre pilot hole drilling program at its BK16 kimberlite in Botswana in February. The program will ensure that the diamond recoveries correlate directly to the geological model for BK16.

The LDD program will collect about 2,000 tons of kimberlite from the two main phases of BK16 by drilling fourteen 24-inch holes. The placement of the holes was designed to provide enough information for grade estimates for the two phases and to get an initial idea of grade distribution across the kimberlite.

Rare Type IIa diamonds have been recovered from BK16, which is about 6 hectares at surface.

KENNADY EAGER to build on proven potential

SITE VISIT | *By Bill Braden*

Kennady Diamonds' (TSXV: KDI) has already tripled early targets at Kennady North, Canada's most advanced diamond exploration project — and there's an eagerness to get going and find more, says president and CEO Rory Moore.

The results of $85 million in spending and four years of determined, methodical exploration have to date probed four kimberlite pipes, labelled Kelvin and Faraday 1, 2 and 3. By year end, the company is aiming to have indicated and inferred resources totaling 20 million carats at grades north of 1.5 carats per tonne at Kennady North, located in the Northwest Territories.

Kennady's maiden resource statement released in December 2016 outlined an indicated resource of 8.5 million tonnes grading 1.6 carats per tonne totalling 13.62 million carats in the Kelvin body alone.

"This year our mission is to get Faraday into an inferred resource," said Moore, who joined Kennady a year ago.

"We want to evaluate those bodies and put a ribbon on them, and move on to the next. But what we are anxious to do is let loose on the exploration because there's so much potential."

Victims of success

On a site visit in late March, 2017, in the cozy Weatherhaven tent that houses Kennady's Kelvin Camp geochem lab, Moore and Gary Vivian, a senior partner with Yellowknife-based Aurora Geosciences, expanded on where the program is to date.

"We believe there could be an inferred resource north of 5 million carats in Faraday," said Vivian, whose company manages the overall project for Kennady. "I think we've just started to scratch the potential of the corridor. . . We think there's more Kelvins and Faradays to be found."

From its start as a spinoff of **Mountain Province Diamonds** (TSX: MPVD; NASDAQ: MPVD) in 2012, Kennady's vision was to prove a resource of five to eight million tonnes of ore at viable grades.

Faraday's three bodies have yet to be fully assessed, but microdiamond results to date have yielded indicative grades of between 2.18 and 3.61 carats per tonne. This compares very favourably with the find that launched the neighbouring Gahcho Kué mine, which went into commercial production this March.

It's been hard to strike a spending balance between exploration and evaluation, said Moore.

"It's been a challenge because we're victims of success. As soon as you find something of significance, it's almost impossible not to get all the drills to concentrate on that. The intention has always been to put some resources into exploration, and the majority into evaluation."

Kennady's 672-sq.-km claim blocks surround the Gahcho Kué

(*Left*) Rory Moore, Kennady Diamonds' president and CEO. Credit: Bill Braden

Aurora Geoscience's Gary Vivian, Moore and project geologist Martina Bezzola in March. Credit: Bill Braden

property on three sides, linked by 10 km connecting it with the main ice road to Gahcho Kué. The 60-person Kelvin Camp has easy access to both the Kelvin and Faraday sites, where over the past three years, Whitehorse-based Midnight Sun Drilling has extracted 1,665 tonnes of kimberlite for bulk sampling.

Good catch

Three decades ago, Moore was a freshly-minted geochemist with a doctorate from his homeland University of Cape Town, South Africa. His first job was analyzing kimberlite for an eccentric geologist named Chuck Fipke in a garage in Kelowna, B.C. His work, during the frenzied months of 1989, helped crack the discovery of what has become the mammoth Ekati project.

"We were drilling left, right and centre and as a young exploration geologist I thought, well, this is easy," recalls Moore, who managed the Ekati exploration program for five more years. "I didn't know how blessed I was to be on a winner project. It was fantastic, marvelous."

When the Kennady board chose Moore as its top executive last May, the ambitious Toronto-based junior made a good catch. It replaced his predecessor and Kennady's founder, the astute mine-maker Patrick Evans, with another veteran of the Canadian diamond industry.

Moore, who had no previous connection to Kennady Diamonds, took over from Evans in a series of strategic moves by Mountain Province, just as Gahcho Kué was coming on stream. Evans had guided that program for almost 20 years, bringing **De Beers** in as managing (and 51%) partner, and needed to focus solely on Mountain Province.

Kennady emerged back in 2012, when Evans put together a plan to move on neighbouring diamondiferous ground just 10 km north of Gahcho Kué. De Beers at the time was focused on mine development, but Evans, convinced the ground shared Gahcho Kué's geological trend, lead the charge for Mountain Province to spin off Kennady as its exploration arm.

In mid-March of this year, Kennady was approached by "interested parties" regarding a potential strategic transaction. Those parties have not been disclosed, and Kennady's board struck a special committee to evaluate the situation, stressing that no formal offers had been received and no agreement reached. It has remained tight-lipped since releasing that information on Mar. 17.

Bill Braden is a freelance writer and photographer based in Yellowknife.

UNDER PRESSURE

5 reasons diamond stocks have been dragging

BY PAUL ZIMNISKY

In the first quarter of 2017, a market-cap weighted aggregation of diamond miners in U.S. dollars including **Alrosa** (RTS: ALRS), **Petra Diamonds** (LSE: PDL), **Dominion Diamond** (TSX: DDC; NYSE: DDC), **Gem Diamonds** (LSE: GEMD), **Lucara Diamond** (TSX: LUC), **Stornoway Diamond** (TSX: SWY), **Firestone Diamonds** (LSE: FDI), and **Mountain Province Diamonds** (TSX: MPV, NASDAQ: MPVD) was up 1.8%, versus the S&P 500, which was up 5.8%.

However, the above figure was skewed by a 29% return in Dominion, as the Canadian pure-play diamond miner drew a takeover proposal at a 36% premium. Taking Dominion out of the above calculation, the basket of diamond miners was down 0.7% in the quarter.

The period from Feb. 15 to March 13 was especially difficult for the diamond miners as the basket was down 14.3%., while the S&P 500 was up 1.1%, making an all-time high on March 1. During that period, $1.8 billion of market cap was erased from the largest pure-play diamond miner in the world as Alrosa's stock declined 14.1%; Dominion shares were down 10 consecutive days (prior to the acquisition proposal), and both Stornoway and Mountain Province made 52-week lows.

The recovery of diamond prices following an industry-wide indigestion in 2015, a resilient post-election U.S. economy and stock market, and a more stable Chinese economy are all fundamentals supportive of diamond miners, but the stocks still displayed relative weakness in the first quarter.

Even the acquisition proposal (a formal bid was not made) in mid-March for Dominion, did not buoy the space. After an initial rally on the Dominion headline, Alrosa, Mountain Province, Gem Diamonds, and Stornoway all retreated back to mid-March lows.

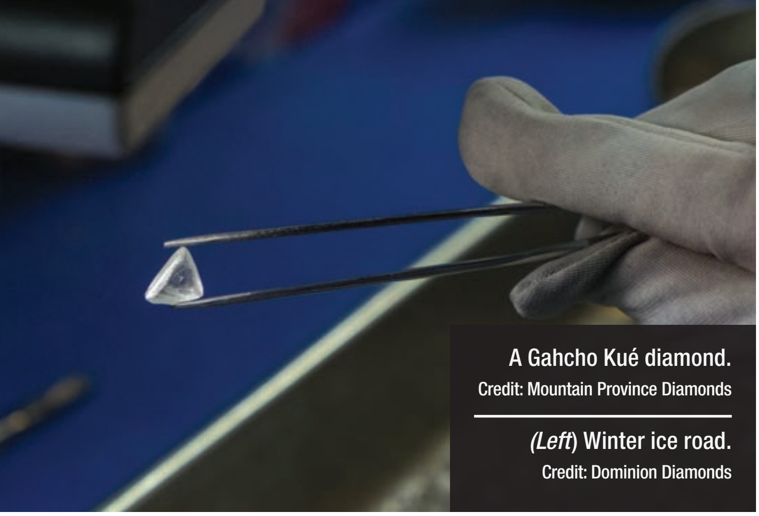
Here are some thoughts as to why:

1 India's demonetization

While the market expected India's demonetization to have a negative impact on global diamond prices, recently released official sales results from Dominion, Stornoway, and Mountain Province have all highlighted the severity of the impact on smaller, lower-quality stones.

In February, Dominion reported that in the three months ending Jan. 31, diamonds from its primary mine, Ekati, only sold for US$77 per carat, down from US$175 per carat in the same period a year ago. In the recent quarter, 90% of Ekati's diamonds came from the Misery Main pipe, which is rich in diamond quantity but poor in diamond quality. A year ago, more carat volume came from Ekati's Koala pipe, which produces diamonds that are typically worth three to four times that of Misery Main. That said, Misery Main diamonds probably would have sold for closer to US$100 per carat without the effect of the demonetization.

In Stornoway Diamond's first ever sale, which was held in November, the company achieved an average price of US$185 per carat. However, the company noted that the price was



A Gahcho Kué diamond.
Credit: Mountain Province Diamonds

(Left) Winter ice road.
Credit: Dominion Diamonds

skewed higher because lower-quality diamonds were withheld from sale due to a lack of demand. In February, the company released 2017 diamond price guidance of US$100-US$132 per carat (inclusive of lower quality stones), which is US$30-US$60 per carat below the mine plan diamond price. Stornoway did note diamond breakage in initial processing, which further increased the distribution of smaller diamonds produced by the company.

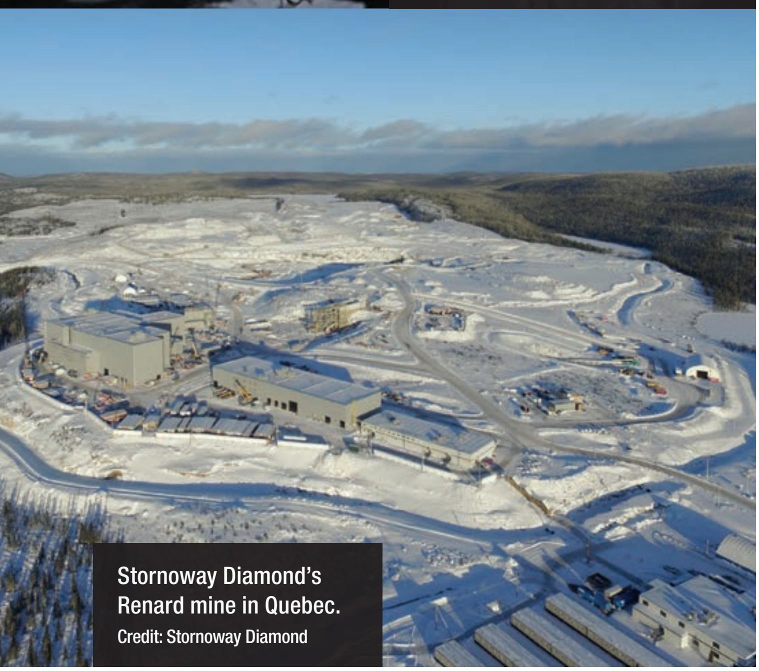
Mountain Province held its first diamond sale from Jan. 16-25, realizing an average price of US$127 per carat, although the company was only able to sell 75% of its offering, as lower-quality, notably brown colored stones, did not sell. The demonetization impacted the company's average price achieved by an estimated 20-30%.

In March, Mountain Province reported that it sold all diamonds that were offered at its second sale, which was held in February, including those that did not sell in the first tender. The company did not disclose the average selling price achieved at its second sale, but in April provided full-year 2017 average price-per-carat guidance of US$70-US$90 per carat, which was well below most expectations.

2 Lucara's bearish view of the diamond market

On Feb 16, in reporting its full-year results, Lucara Diamond struck a bearish note in its commentary, remarking that supply and demand fundamentals in the market remained unbalanced, resulting in a very cautious market. "The large volume of rough diamonds sold into the market in 2016 has not translated into increased sales of polished diamonds. Polished diamond price indices remain at very low levels, restricting the ability for rough diamond prices to see short term and sustainable growth."

A 373.72-carat stone from Lucara Diamond's Karowe mine.
Credit: Lucara Diamond



Stornoway Diamond's Renard mine in Quebec.
Credit: Stornoway Diamond

The company also noted that demonetization in India towards the end of 2016 resulted in low to almost no liquidity for polishers, and although this is a short-term concern, new supply coming onstream by three new producers may continue to affect prices for smaller and lower-quality rough stones.

After recovering the second largest rough diamond in history in 2015, the Lesedi La Rona, subsequent publicity has made Lucara one of the most well followed and recognizable diamond miners in the world. Since then, Lucara's comments have impacted industry sentiment more than larger companies like Alrosa and Petra, which have both recently released more bullish views on the current state of the diamond market.

3 Rising interest rates

With the U.S. Federal Reserve raising interest rates on March 15, with subsequent additional hikes expected in 2017, there has been some rotation out of higher-yielding stocks into fixed income.

With Dominion, Lucara, and Alrosa yielding 4.3%, 3.6%, and 2.4%, respectively, which compares to the S&P 500 yielding 2.2%, these diamond miners are relatively high-yielding stocks, and are sensitive to asset class rotation tied to interest rates.

In addition, more hawkish monetary policy rhetoric has strengthened the U.S. dollar, which has also put pressure on the diamond miners, most of which are traded in non-U.S. dollars.

4 A general rotation out of commodity investments

Iron ore, gold and oil have been driven lower by weaker sentiment of late. After surging 80% in 2016, iron ore is expected to be weaker in 2017 as a higher price, which was driven by government stimulated Chinese steel production, has led to global production capacity expansion. In February, the largest diversified miner in the world, **BHP Billiton** (NYSE: BHP LSE: BLT)), expressed caution, saying: "The (iron ore) market is likely to come under pressure in the short-term from moderating Chinese steel demand growth, high port inventories and incremental low-cost supply."

In mid-March, gold dipped as the pending Fed rate raise depressed demand for gold as an inflation hedge. The gold price has since rallied, but remains volatile as the desire to own the safe haven fluctuates with every action taken by the new Trump administration and as the Euro-sensitive French election unfolds.

WTI crude oil has sold off over 11% since the beginning of the year as the rally in December, driven by an OPEC supply curtailment announcement, has given way to concern over increased U.S. shale oil production.

Large investors tend to move money in and out of asset classes and sectors as a whole, so a general flowing of money out of commodities and related stocks has sympathetically impacted the diamond miners.

5 Negative sentiment towards diamonds driven by coverage in the Economist

Widely read global financial publication The Economist recently published an article on how the "velben good" nature of diamonds is eroding. The article points to De Beers no longer controlling supply, the technological advancement of synthetic diamond production, and Millennials' lackluster desire for material possessions, as threatening the value of diamonds.

While all of these topics are far from new to those in the industry, the widely distributed article put a negative spin on the longer-term prospects of the diamond industry.

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Gahcho Kué diamonds.
Credit: Mountain Province Diamonds

Gahcho Kué achieves commercial production

Seven months after turning out its first diamonds last August, **De Beers** and **Mountain Province Diamonds**' (TSX: MPVD; NASDAQ: MPVD) Gahcho Kué mine in the Northwest Territories began commercial production on Mar. 1.

In the first quarter ended Mar. 31, 867,000 carats were recovered from 492,000 tonnes of ore processed for a grade of 1.76 carats per tonne, 49% owner Mountain Province reported in April.

But prices achieved in the quarter suffered from both demonetization in India and the lower-quality diamonds found in the upper levels of the Northeast Lobe of the 5034 kimberlite.

While prices were lower than the expected average for the 5034 kimberlite as a whole, Mountain Province president and CEO Patrick Evans expects prices to improve as market conditions normalize and more production is sourced from the Centre Lobe of the kimberlite.

"The first quarter diamond sales reflect the experience of a new entrant to the market, as buyers develop familiarity with the sell-through value of the company's production," Evans said in a release.

"The unexpected headwinds from demonetization in India compounded customary weakness during the price discovery period. Importantly, we have seen a steady improvement in our early sales results and are very encouraged that 72 per cent of the winning bidders at our March sale were repeat buyers."

Based on performance so far, the company released guidance for 2017 on a 100% basis of 40 million tonnes mined, with 2.7 million tonnes processed to recover 4.4 million carats at a grade of 1.62 carats per tonne. Mountain Province expects to receive US$70 to US$90 per carat for the balance of the year.

In a research note in late April, Haywood Securities analyst Geordie Mark wrote that the new pricing estimates for 2017 are considerably below the original base case scenario, even considering current market conditions and other pricing discounts.

The greater than expected variability in the quality and size frequency distribution in the top part of the Northeast Lobe of the 5034 kimberlite presents a pricing risk, Mark said. However, earlier size frequency data shows that the Centre Lobe hosts a greater population of larger diamonds.

Mark lowered his target for Mountain Province to $6.30 per share from $7 in late April, when the company traded at $4.53.

Full production at the mine, which is operated by De Beers, is expected mid-year.

Stornoway deals with Renard hiccups

Stornoway Diamond's Renard mine in Quebec.
Credit: Stornoway Diamond

Stornoway Diamond (TSX: SWY) had an exceptionally smooth build at its Renard mine, in Quebec, which was completed five months ahead of schedule and under budget by $37 million. Renard achieved commercial production (defined as 60% of capacity) on Jan. 1, and has been on track in terms of ore production with better than expected grades. But there have been some hiccups in the new miner's early days.

"Four days before we had our first sale in November, Prime Minister Modi of India demonetized the Indian economy," president and CEO Matt Manson told *The Northern Miner* in an interview in late March. "And that hit us like a ton of bricks, because all of the small-scale diamond polishers are in India. The mom and pop businesses in Surat and Gujarat, which are in the tens of thousands, they work in cash. So their ability to buy product and pay their workers was taken away in mid-November just as we were to have our first sale."

Renard produced 448,887 carats at a grade of 112 carats per hundred tonnes last year — both figures well ahead of plan.

But Stornoway only sold 38,913 carats at its first sale last year. However, because it withdrew some smaller diamonds from sale, the average received price was US$195 per carat — a price that can't be seen as representative for future sales.

In addition to a lack of demand for smaller and lower-quality diamonds, diamond breakage in the Renard plant has also been an issue, resulting in a higher proportion of smaller diamonds than expected.

The breakage issues in the plant aren't unusual in new diamond mines.

"Diamonds are surprisingly fragile even though they are the hardest mineral," Manson said.

The company is in the process of consulting with experts to reduce breakage levels.

As a result of the uncertainty in the diamond market, Stornoway has been cautious with its price forecast for 2017. In February, it released production guidance of 1.7 to 1.8 million carats at an average price of US$100-US$132 per carat for 2017.

Despite the lack of demand at the lower end of the market, Renard product has been well received, Manson said.

"The first couple of sales, people are a little cautious because they don't know how it's going to come out, how the stones are going to perform on the polishing wheels. They don't know how the colour is going to change, or the fluorescence," Manson said.

However, subsequent sales have been better, Manson said. "We just closed our fourth sale and it was terrific. We were healthily over our reserve pricing in every category."

Larger, higher-quality goods from Renard are seeing strong premiums. Notably, brown diamonds from the mine have been selling well because their colour improves with polishing.

"By our second or third sale, we realized the prices we were getting bid for our brown stones were going through the roof. And some wanted to corner the market on them, because they realized that they were polishing lighter and they were making a lot of money on them," Manson told *The Northern Miner.*

The company has received 25-30% higher prices for brown diamonds in recent sales compared to its first.

—With files from The Northern Miner.

Manitoba discovery *stirs interest*

Following up on an initial diamond discovery in Manitoba from 2008, a group of prospectors working with the Manitoba Geological Suvey (MGS) has found diamonds in the Knee Lake area of northeast Manitoba.

The Lynx Consortium announced the find in March, and Mark Fedikow, a consultant and member of the consortium, says it opens up a whole new field of exploration potential for the province as well as opportunities for northern and First Nations communites.

"It also demonstrates the value of good geoscience data collection — the Manitoba Geological Survey were extremely important in the discovery because of their geological input," Fedikow adds.

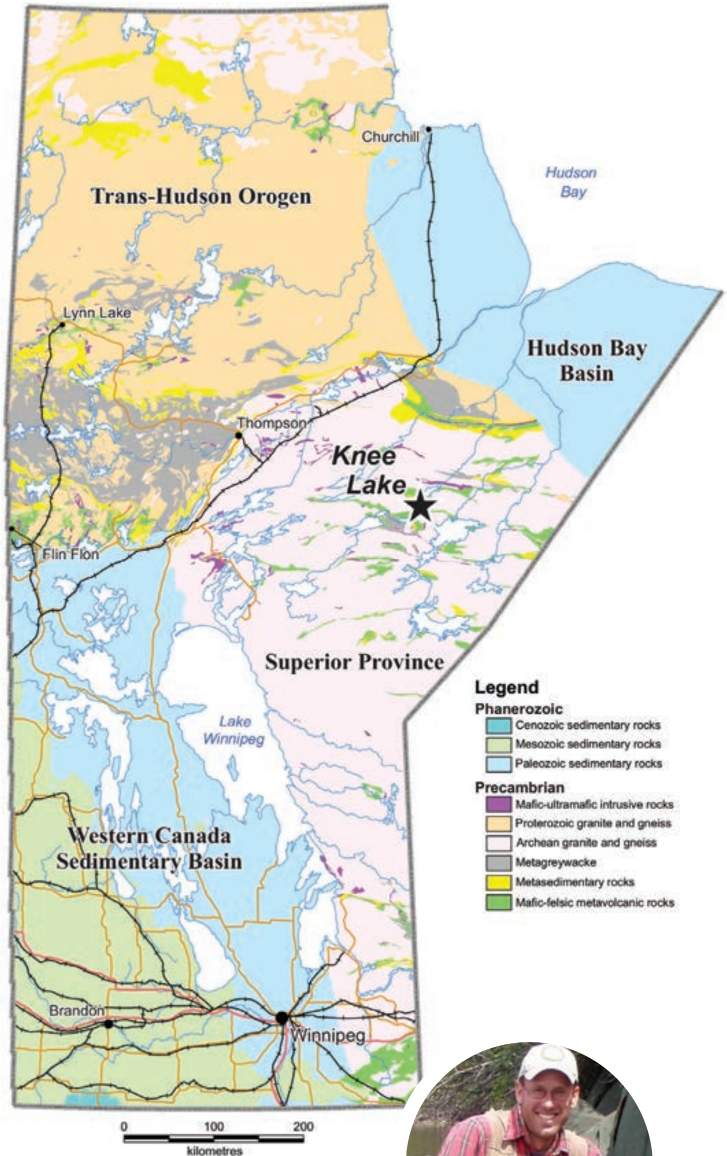
The Knee Lake area saw exploration between 1999 and 2004 by both majors like **BHP Billiton** (NYSE: BHP), **De Beers** and Kennecott and juniors following an MGS multimedia geochemical survey that found anomalous concentrations of kimberlite indicator minerals (KIMs) in glacial till and beach sand. (At the time, Fedikow was one of the MGS geologists who headed up the initial survey.)

The first incidence of diamonds found in bedrock in the province was in 2008 when a microdiamond was recovered an 8-kg split sample of conglomerate exposed in outcrop. The sample was taken by Robin Day, a member of the Lynx Consortium who Fedikow met after his initial discovery.

In 2016, Day's company Polaris Capital, Fedikow's company Mount Morgan Resources, Harold Westdal and John Lee's company Indicator Explorations acquired exploration licences in the Knee Lake area totalling 500 sq. km.

The consortium worked together with the MGS to put together a sampling program for diamonds to carry out in the course of the Survey's bedrock mapping program. In late 2016, MGS geologist Scott Anderson collected a sample of conglomerate (Sample 1) and two samples of alkaline ultramafic volcaniclastic and sedimentary rocks (Sample 2 and 3) at South Knee Lake. Microdiamond and KIM analyses of the samples was funded by Fedikow's consultancy Mount Morgan Resources.

A total of 144 microdiamonds were recovered from Sample 2, a 15.8-kg split, including four diamonds that were larger than 0.3 mm and one that was 0.43 mm. Of the larger stones, four are white/colourless or yellow/transparent and all contained minor or no inclusions.



Manitoba Geological Survey geologist Scott Anderson

Since making the discovery in Archean rocks in the Archean Oxford House-Knee Lake greenstone belt, Lynx Consortium has been in talks with companies interested in a potential joint venture at Knee Lake.

Fedikow antipates making an option agreement with one of them by summer, followed by a program of work that will hopefully determine what the host rock is: Fedikow says the microdiamonds weren't found in kimberlite.

"We don't know much about what the host rock is right now. The primary mineralogy of the rock has been replaced — basically it's a lot of chlorite — sort of a clay mineral."

Fedikow says it's possible that the discovery is a new type of deposit or an altered equivalent of a kimberlite.

"It's an Archean greenstone belt which makes the diamonds a little unusual because most diamonds are younger than Archean in age. But there's every reason why there could be an economic deposit of diamonds in Archean rocks — it's just not something that's been the norm in the past."

Dominion

explores options after takeover approach

The main camp at Dominion Diamond's Ekati mine.
Credit: Dominion Diamond

It's been an eventful year for **Dominion Diamond** (TSX: DDC; NYSE: DDC), with the company receiving an unsolicited takeover approach in February, shortly after CEO Brendan Bell announced his resignation in January.

The initial approach from U.S.-based Washington Corps., was made in February, but did not become public until Mar. 19. Dominion's board dismissed the $1.1-billion, $13.50-per-share proposal as "highly opportunistic" and cast doubt on Washington Corps.' credibility in the diamond mining and marketing worlds. Dominion also stressed that it never received a formal offer. Run by Dennis Washington, the company has mining, marine, rail transportation and heavy equipment distribution businesses in North America.

But on Mar. 27, Dominion announced that it was exploring "strategic alternatives" to maximize shareholder value. And by May 1, the company had given access to its data room to interested parties, including Washington Corps., after they signed confidentiality agreements.

The company also noted in May that its search for a new CEO was well under way, although there was no timetable for an appointment.

Bell, who took over as acting CEO in late 2014 and was appointed permanently in the role in mid-2015, is stepping down in June rather than move his family to the company's new headquarters in Calgary. The company had been based in Yellowknife.

In a note in early May, BMO Capital Markets analyst Edward Sterck noted that Dominion's search for a CEO is effectively on hold. "Washington requested that Dominion not appoint anyone whilst the strategic review process was being run," he said. "We can understand Washington's desire not to have to pay unnecessary severance costs if it is successful in acquiring Dominion, but leaving the company without leadership for an extended and unknown period of time might also seem unfair to existing shareholders."

Dominion also faced a challenge from activist shareholders in 2015, resulting in changes in the board and management team.

In its latest financial results, Dominion reported revenue of US$570.9 million, down from US$720.5 million the previous year. It recorded a loss before income taxes of US$40.7 million compared to a loss of US$11.6 million a year earlier.

Fourth quarter revenue declined to US$129.9 million from US$178.1 million a year earlier. It did not make a profit for the quarter, compared with a year earlier loss of US$27.9 million.

Affecting the results was the higher proportion of lower-value goods sold from the company's operations. The fourth quarter was also affected by a fire at its Ekati plant and India's demonetization. Dominion's average price per carat sold declined to US$87 per carat in fiscal 2017 from US$177 the previous year.

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