Lucara Diamond Corp.

Condensed Interim Consolidated Financial Statements
For the three and nine months ended September 30, 2012
(Unaudited)

LUCARA DIAMOND CORP.
MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2012

Management's discussion and analysis ("MD&A") focuses on significant factors that have affected Lucara Diamond Corp. (the "Company") and its subsidiaries performance and such factors that may affect its future performance. In order to better understand the MD&A, it should be read in conjunction with the unaudited condensed interim consolidated financial statements for the three and nine months ended September 30, 2012, which are prepared in accordance with IAS 34: Interim Financial Statements, and the audited consolidated financial statements of the Company for the year ended December 31, 2011, which are prepared in accordance with International Financial Reporting Standards. All amounts are expressed in U.S. dollars unless otherwise indicated. The effective date of this MD&A is November 9, 2012.

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.

FINANCIAL RESULTS[1]:

Karowe Mine - Botswana (formerly AK6 Diamond Project)

- Commercial Production was declared as of July 1, 2012. As a result, diamonds produced and sold post July 1, 2012 are recognized as revenue in the Company's condensed interim consolidated statements of operations. The July sale and 489 carats of diamond sold in the September sale included diamonds produced prior to July 1, 2012 and their earnings were netted against capitalized project costs in the condensed interim consolidated balance sheet.

- Completed two sales totalling 88,579 carats for proceeds of $19.9 million during the quarter in the months of July and September.

- Achieved an average sales price of $179 per carat for the July sale (with some high value lots withheld) and $257 per carat in the September sale, which included three lots of diamonds previously withheld.

- Operating expenses per carats sold in the September sale was $107 per carat.

- Cash operating earnings reported for the September sale (excluding depreciation, amortization and depletion) was $5.9 million or 46% of gross revenue.

- Average grade processed during the quarter was 15.4 carats per hundred tonnes. Year to date grade processed was 19.6 per hundred tonnes, which was marginally below forecast.

Mothae Project - Lesotho

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

---

[1] The Company's financial results are prepared in accordance with IFRS. This MD&A refers to cash operating earnings and EBITDA, which are not measures recognized under IFRS and do not have a standardized meaning prescribed by IFRS. Refer to the "Non-GAAP Measures" section in this MD&A for further details.

Corporate

- Cash on hand was $11.1 million at September 30, 2012 including a $7 million drawdown from the Company's Scotiabank credit facility.

- In July, the Company renegotiated the terms of its $50 million debenture. Under the amended terms of the agreement each scheduled principal payment has been extended by six months resulting in payments commencing in March 31, 2013 and a final maturity date of June 30, 2014. All other terms and conditions of the debenture agreement remain unchanged with no penalties being incurred.

OPERATIONAL RESULTS:

Karowe Mine - Botswana (formerly AK6 Diamond Project)

- There were no Lost Time Injuries ("LTI's") or reportable environmental incidents at Karowe during the quarter continuing its excellent safety, health and environment record. There have been over 2.5 million hours worked without any LTI's since March 2011, including 1.3 million hours since the beginning of 2012. The Karowe Mine has achieved a lost time injury frequency rate ("LTIFR") of 0.07. Year to date 2012 LTIFR is zero.

  By August 2012, the mine ramped up to full process plant throughput with September running at 14% above design capacity. A total of 594,000 tonnes were milled producing 91,400 carats during the quarter.

- Progress was made in increasing water supply for operations. The equipping of additional boreholes, increased return water from the slimes dam and improved operating efficiency, resulted in operations meeting and then exceeding design capacity during the quarter.

Mothae Project - Lesotho

- A total of 4,657 carats of diamond were sold in September for gross proceeds of $1.5 million or an average price of $324 per carat.

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

- A small team will remain on site into the fourth quarter to reprocess x-ray recovery tailings as an audit of diamond recovery efficiencies. Otherwise, the project has been put on care and maintenance as work continues on completing a Preliminary Economic Assessment ("PEA") of the Mothae kimberlite. The PEA is expected to be completed during the first quarter of 2013.

- Work on the PEA during the quarter focused on finalizing the resource model, developing a preliminary mine plan, developing a preliminary infrastructure layout design and conducting detailed reviews of process plant design options.

INTRODUCTION

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

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

The following summarizes the Company's current land holdings:

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

Karowe Mine, Botswana (formerly AK6 Diamond Project)

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

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

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

In August, Karowe production exceeded design capacity on several shifts. Ramp-up to full process plant throughput, therefore, was achieved in a little over four months having overcoming water supply and water demand issues. In September, 233,507 tonnes were processed which was 14% above design capacity. For the quarter, a total of 594,000 tonnes were milled producing 91,480 carats.

The mine dewatering projects were well advanced during the third quarter. The equipping of additional boreholes added to the water supply, and this was effectively supplemented by return water from the slimes dam. These projects, along with reduced water consumption per tonne treated, as the operations team optimized the AG mill operation, enabled the mine to meet and then exceed design capacity within the third quarter. In October, for the first time since start-up, primary, fresh kimberlite was mined and processed. This competent ore impacted the mill throughput as it takes longer to breakdown than the weathered ore. Mill operational optimisation work is ongoing to achieve sustained design tonnage throughput.

During the quarter, the mine successfully conducted two sales earning proceeds of $19.9 million. The Company withheld goods from the July sale as the rough diamond market softened, especially in the high-color, high-quality diamond categories. This was due to the diamonds not being offered a competitive price for the quality of goods on sale. For the September sale, viewings were held in both

Gaborone and Antwerp increasing the client base substantially. All goods withheld in the July sale were sold in September. Viewings for the September sale were held in both Gaborone and Antwerp, which resulted in three times the number of people attending viewings compared to viewings being held solely in Gaborone in June and July.

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

There were no LTI's or reportable environmental incidents at Karowe during the quarter continuing its excellent safety, health and environment record. There have been over 2.5 million hours worked without any LTI's since March 2011, including 1.3 million hours since the beginning of 2012. The Karowe Mine has an LTIFR of 0.07.

Mothae Project, Lesotho

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

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

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

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

The trial mining program was completed in September 2012. A small team remains on site into the fourth quarter to reprocess x-ray recovery tailings through the Bourevestnik X-ray unit as an audit of process plant recovery efficiencies. Otherwise, the project has been put on care and maintenance as work continues on completion of the PEA.

Performance during the three and nine months ended September 30, 2012

The Company completed a diamond sale on September 14, 2012. A total of 4,657 carats of diamond were sold for gross proceeds of $1.5 million for an average price of $324 per carat. The sale consisted of 32 lots of which 26 were sold on a sealed tender at the offices of Bonas-Couzyn in Antwerp.

Trial mining continued in the central portion of the south lobe of the Mothae kimberlite, and focused on extraction of a sample of fresh, unweathered kimberlite from the south central domain to determine diamond grade and liberation characteristics of this material as compared to the overlying soft, weathered kimberlite. Samples F3A, CD1B and CD1C were completed during the quarter.

Sample F3A consists of material in a geologic transition zone between the west resource domain and the central resource domain of the south lobe of the Mothae pipe. This sample was processed primarily to gain mining access to the central resource domain and also to provide additional diamond size, grade and value data. F3A produced 365.91 carats of diamond from 7,659 dry tonnes of kimberlite for an average sample grade of 4.78 cpht and had an average stone size of 0.63 carats per stone.

Sample CD1B consists of central domain kimberlite in the transition zone between overlying soft weathered kimberlite and underlying hard unweathered kimberlite. CD1B produced 2,936.74 carats of diamond from 52,559 dry tonnes of kimberlite for an average sample grade of 5.59 cpht and had an average stone size of 0.44 carats per stone.

Sample CD1C consists of hard fresh kimberlite from the central resource domain of the Mothae pipe and is representative of the bulk of the central domain resource in terms of processing and diamond liberation characteristics. CD1C yielded 262.07 carats from 5,563 dry tonnes of kimberlite for an average sample grade of 4.71 cpht and had an average stone size of 0.50 carats per stone. This sample was the final kimberlite material processed in the trial mining program.

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

Fiscal Period	**Wet Tonnage**	**Dry Tonnage**	**Stones**	**Carats***	**Ave Stn Size (ct/stone)**	**Dry Grade (cpht)***
Pre 2010	99,959	82,328	8,894	3,873.21	0.44	4.68
FY 2010	160,686	137,578	8,753	3,659.58	0.42	2.66
FY 2011	240,652	206,998	20,368	9,521.59	0.47	4.60
Q1 - Q2 2012	131,364	118,793	6,786	3,191.74	0.47	2.69
Q3 2012	63,277	58,122	7,216	3,199.70	0.44	5.51
TOTALS	**695,938**	**603,819**	**52,017**	**23,445.82**	**0.45**	**3.88**

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

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

Work on the PEA of the Mothae kimberlite during the quarter focused primarily on:

- final processing of hard kimberlite as input for process plant design and ore characterization studies on the central resource domain of the south lobe,
- incorporation of detailed core logging into the global geologic model of the Mothae pipe to refine the internal geologic model of the kimberlite and estimate tonnage potential of various resource domains,
- incorporation of recent diamond sales data with previous diamond sales results and combining this information with diamond size frequency distribution and estimated grade for the hard, unweathered kimberlite to generate revenue model for the resource,

- development of a provisional mine design and mine plan,
- finalization of conceptual layouts for site infrastructure, and
- review of process plant design components and a high level assessment of costs for various design options.

QUARTERLY RESULTS REVIEW *(unaudited)*

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

Summary Financial Information:

In millions of U.S. dollars unless otherwise noted	**Three months ended September 30** **2012**	2011	**Nine months ended September 30** **2012**	2011
Revenues	$ 12.7	$ -	$ 12.7	$ -
Operating expenses	(5.5)	-	(5.5)	-
Royalty expenses	(1.3)	-	(1.3)	-
Cash operating earnings [(1)]	**5.9**	-	**5.9**	-
Exploration expenditures	(4.5)	(3.1)	(10.6)	(7.2)
Administration	(3.0)	(1.3)	(7.7)	(5.9)
Gain on sale of diamonds	-	-	-	2.3
Sales and marketing	(0.7)	-	(0.7)	-
EBITDA [(2)]	**(2.3)**	(4.4)	**(13.1)**	(10.8)
Depletion, amortization and accretion	(2.2)	-	(2.1)	-
Finance income (expenses)	(1.2)	0.3	(1.7)	(0.2)
Foreign exchange gain (loss)	2.3	(1.4)	1.8	(2.2)
Net loss for the period	**(3.4)**	(5.5)	**(15.1)**	(13.2)
Total equity	**151.5**	175.2	**151.5**	175.2
Cash flow from operations (before working capital adjustments)	**(2.5)**	(4.4)	**(11.3)**	(10.7)
Total assets	**231.9**	227.2	**231.9**	227.2
Cash on hand	**11.1**	70.7	**11.1**	70.7
Loss per share (basic and diluted)	**(0.01)**	(0.01)	**(0.04)**	(0.04)
Per carats sold				
Sales price	**$245**	$ -	**$245**	$ -
Operating expenses	**107**	-	**107**	-
Average grade (carats per hundred tonnes)	**15.4**	-	**19.6**	-

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

Reconciliation of Revenues:

Karowe sales during the third quarter	**Carats**	**Proceeds (US$ million)**	**US$ per carat**
July sale	36,353	$6.5	$179
September sale	52,226	13.4	257
	88,579	**19.9**	**225**
Diamonds produced pre-commercial production and sold during the third quarter			
July sale	36,353	6.5	179
September sale	489	0.7	1,431
	36,842	**7.2**	**195**
Revenues reported	**51,737**	**12.7**	**245**

Three months ended	Sept-12	Jun-12	Mar-12	Dec-11	Sept-11	Jun-11	Mar-11	Dec-10
A. Total revenues	12,658,547	Nil	Nil	Nil	Nil	Nil	Nil	Nil
B. Exploration expenditures	4,464,791	2,798,489	3,313,504	(564,851)	3,116,383	2,866,454	1,200,247	2,688,388
C. Administration expenses	2,979,850	3,392,079	1,363,964	2,254,982	1,304,914	1,845,748	2,776,978	1,821,675
D. Net loss	3,413,079	7,607,000	4,169,711	5,438,374	5,453,107	5,921,521	1,860,890	4,821,819
E. Loss per share (basic and diluted)	0.01	0.02	0.01	0.01	0.01	0.02	0.01	0.02

Revenues

During the third quarter the Company had two sales totalling 88,579 carats for gross proceeds of $19.9 million at an average price of $225 per carat. The Company's sale in July resulted in an average price of $179 per carat including withholding some high value lots sold in the September sale. The September sale achieved an average price of $257 per carat or $245 per carat excluding the high value lots withheld from the July sale.

The Company's revenues for the third quarter do not include the July sale or 489 carats of diamond sold in the September sale as these diamonds were produced pre-commercial production and under IFRS are reported as part of plant and equipment. Therefore third quarter gross revenues of $12.7 million include only the September sale of 51,737 carats, which is net of the 489 carats produced in the pre-commercial production period.

Cash operating earnings

Third quarter cash operating earnings was $5.9 million during the period. This reflects a $245 per carat price received for goods sold in September net of royalties of 10% and at operating expenses per carats sold of $107 per carat.

Cash operating earnings of $5.9 million result in a gross margin of 46% on September sales. Average grade for the quarter was 15.4 carats per hundred tonnes.

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

Exploration expenditures

Exploration expenditures were $4.5 million during the quarter largely relating to Mothae's trial mining program, which commenced in May 2010. Mothae exploration costs include work on Mothae's preliminary economic assessment and further costs for non-recurring care and maintenance costs.

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

Administration expenses

The increase in administration expenses for the year to date period ended September 30, 2012 compared to the prior year is largely to the accrual of performance incentive bonuses to key employees of the Company and other non-recurring costs.

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

EBITDA for the quarter was a loss of $2.3 million. EBITDA was impacted by:

- Exclusion of Karowe's July sale of 36,353 carats for proceeds of $6.5 million and related operating expenses and royalty expenses. This sale has not been included in the condensed interim consolidated statement of operations and therefore gross margin and EBITDA for the third quarter. The gross margin from this sale has been credited against capitalized plant and equipment.

- Exploration expenditures of $4.5 million at Mothae were due to its trial mining program and costs incurred for its preliminary economic assessment. Mothae has now been placed on care and maintenance with limited operating expenditure going forward.

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

LIQUIDITY AND CAPITAL RESOURCES

As at September 30, 2012, the Company had cash and cash equivalents of $11.1 million compared to cash and cash equivalents of $48.6 million at December 31, 2011.

Cash used in operating activities before working capital movements for the quarter ended September 30, 2012 was an outflow of $2.5 million. This includes the September Karowe sale with operating earnings of $5.9 million as well as Mothae's September sale for proceeds of $1.5 million. These proceeds were offset by Mothae's exploration costs to complete its trial mining program and work on the preliminary economic assessment as well as corporate costs. The July sale with proceeds of $6.5 million has been included as part of investing activities and not operating cash flows as this sale included pre-commercial production and was reported net of costs in capitalized plant and equipment.

Net cash from financing activities for the nine months ended September 30, 2012 included a $7 million drawdown on the Scotiabank credit facility.

In April the Company signed a definitive agreement with the Bank of Nova Scotia for a $25 million revolving term credit facility with a maturity date of March 26, 2014, which may be extended if both parties agree. As at September 30, 2012 the Company had drawn down $7 million of the credit facility.

The facility contains financial and non-financial covenants customary for a facility of this size and nature. The applicable interest rate of any loan under the facility will be determined by the Company's leverage ratio at any given time. The Company will provide security on the two year facility by way of a charge over the Company's Karowe assets and a guarantee by the Company's subsidiaries, which hold the Karowe assets.

The Company intends to use the facility to meet periodic working capital requirements as required.

FUTURE PLANS AND OUTLOOK

Karowe Mine, Botswana

Karowe will continue to mine and process ore in 2012 to achieve a targeted production of 270,000 carats and sales of approximately 230,000 carats. Detailed production plans and budget for 2013 will be presented to the Board for approval in the fourth quarter.

The Company anticipates holding two further diamond sales in late November and mid December 2012 with viewings being conducted in both Gaborone and Antwerp.

Mothae Project, Lesotho

Work on the PEA is ongoing and is expected to be completed during the first quarter of 2013.

NON-GAAP FINANCIAL MEASURES

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

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

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

CRITICAL ACCOUNTING ESTIMATES

The application of certain accounting policies requires the Company to make estimates that affect both the amount and timing of the recording of assets, liabilities, revenues and expenses. Some of these estimates require judgments about matters that are inherently uncertain. For a complete discussion of accounting estimated deemed most crucial by the Company, refer to the Company's annual 2011 Management's Discussion and Analysis.

The following are additional critical accounting estimates deemed most crucial by the Company during the period:

Commercial production – Operating levels intended by the Company

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

Depreciation, depletion and accretion

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

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

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

RELATED PARTY TRANSACTIONS

During the nine months ended September 30, 2012, The Company incurred the following expenses with Namdo Management Services Limited ("Namdo") and Lundin Foundation ("LF"), companies related by way of directors in common. In addition the Company incurred air chartered services from Mile High Holdings Ltd. ("Mile High"), a company associated with the Chairman of the Company. The Company also incurred professional geological services and laboratory related expenditures from the Mineral Services Group ("MS Group"), a company that is associated with a director of Company.

Description of services	**Related party**		**September 30, 2012**		**September 30, 2011**
Management fees	Namdo	$	377,093	$	376,464
Donations	LF		-		613,800
Exploration related expenditures	MS Group	$	1,587,492		-
Aircraft charter	Mile High	$	368,760		306,605
		$	2,333,345	$	1,296,869

OUTSTANDING SHARE DATA

As at the date of this MD&A, the Company had 376,292,749 common shares outstanding and 4,315,000 stock options outstanding under its stock-based incentive plan. As at the same date, the Company had no stock purchase warrants outstanding.

FINANCIAL INSTRUMENTS

The Company classifies financial instruments as financial assets and liabilities at fair value through profit or loss, available-for-sale investments, loans and receivables or financial liabilities at amortized cost. The Company's financial instruments consist of cash and cash equivalents, investments, trade receivables and other, trade payables and accrued liabilities, due to related parties and long-term debt.

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

CONTINGENCIES

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

In September 2011, the Plaintiffs, now referred to as the Appellants, filed a Notice of Appeal in respect of the judgment. The Appellants requested an order setting aside the judgment in August 2011.

The case went to the High Court in Botswana on April 19, 2012 in order to set the record of appeal. The Parties are still waiting on confirmation from the Registrar of the Appeal Court on when the Appeal is to be heard.

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

RISKS AND UNCERTAINTIES

The operations of the Company are speculative due to the high risk nature of its business which includes acquisition, financing, exploration, development and operation of diamond properties. These risk factors could materially affect the Company's future operations and could cause actual events to differ materially from those described in forward-looking statements relating to the Company.

The risk factors which should be taken into account in assessing the Company's activities, include, but are not necessarily limited to, those set out in the Management's Discussion and Analysis for the year ended December 31, 2011.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements.

FINANCIAL INFORMATION

The report for the year ended December 31, 2012 is expected to be published on March 21, 2013.

MANAGEMENT'S RESPONSIBILTY FOR THE FINANCIAL STATEMENTS

The Audit Committee is responsible for reviewing the contents of this document along with the interim quarterly financial statements to ensure the reliability and timeliness of the Company's disclosure while providing another level of review for accuracy and oversight. There have been no changes in the Company's disclosure controls and procedures during the three and nine months ended September 30, 2012.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the accounting principles under which the Company's financial statements are prepared. An evaluation of the effectiveness of the Company's internal control over financial reporting was conducted as of December 31, 2011 by the Company's management, including the Chief Executive Officer and Chief Financial Officer. Based on this evaluation, management has concluded that the Company's internal controls over financial reporting were effective.

As required under Multilateral Instrument 52-109, management advises that there have been no changes in the Company's internal control over financial reporting that occurred during the most recent interim period, being the three and nine months ended September 30, 2012, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

Certain of the statements made and contained herein in the MD&A constitute forward-looking statements as defined in applicable securities laws. Generally, these forward-looking statements include any statements with respect to predictions, expectations, beliefs, plans, projects, objectives, assumptions or future events or performance and often (but not always) can be identified by the use of forward-looking terminology such as "expects", "anticipates", "believes", "intends", "estimates", "potential", "possible" and similar expressions, or statements that events, conditions or results "will", "may", "could" or "should" occur or achieved.

Forward looking statements are based on the opinions and estimates of management as of the date such statements are made, and they are subject to a number of known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievement expressed or implied by such forward-looking statements. In particular, this MD&A contains forward looking information pertaining to the following: the estimates of the Company's mineral reserve and resources; estimates of the Company's production and sales volumes for the Karowe Mine; estimated costs to construct the Karowe Mine, start-up, exploration and development plans and objectives, production costs, exploration and development expenditures and reclamation costs; expectation of diamond price and changes to foreign currency exchange rate; expectations regarding the need to raise capital;

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. Forward-looking statements are subject to a variety of known and unknown risks, uncertainties and other factors that could cause actual events or results to materially differ from those reflected in the forward-looking statements including, without limitation, the following risks and uncertainties for the Company: general global financial and economic conditions; future market prices for diamonds; the supply and demand for rough diamonds; ability to access capital; fluctuations in interest rates and foreign currency exchange rates; inherent hazards and risks associated with mining operations; estimations of the Company's production and sales volume for the Karowe Mine; costs associated with the construction of the Karowe mine; operational costs, including costs of power and diesel; operational difficulties, including failure of plant, equipment or processes to operate in accordance with specifications or expectations; industrial job disturbances; environmental and other regulatory requirements, including changes in the same; the acts of the governments of the jurisdictions in which the Company's operations are located; obtaining governmental approvals and permits; estimation of mineral resources, including the continuity of grade of diamondiferous mineralization; risks related to property titles; the dependence on transportation facilities and infrastructure; the Company is required to carry uninsurable risks; the mining industry is competitive; risks associated with current and future legal proceedings; conflicts of interest; dependence on management and technical personnel; and risks associated with volatility in the securities market.

Certain of these risks are discussed under the heading "Risk Factors' in the Company's Annual Information Form dated March 22, 2012 available at http://www.sedar.com. This list is not exhaustive of the factors that may affect any of the Company's forward-looking statements. Forward-looking statements are statements about the future and are inherently uncertain, and actual achievements of the Company or other future events or conditions may differ materially from those reflected in the forward looking statements due to these risks, uncertainties and other factors. Accordingly, readers are cautioned not to place undue reliance on these forward-looking statements. The Company disclaims any intention or obligation to update or revise forward-looking statements if circumstances or management's beliefs, expectations, or opinions should change, except as required by law.

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

	September 30, 2012	December 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$ 11,074,641	$ 48,589,409
Investments	86,659	109,020
VAT receivables and other	4,210,721	6,298,262
Inventories (Note 3)	7,684,310	1,597,255
	23,056,331	56,593,946
Plant and equipment (Note 4)	121,311,288	94,501,245
Mineral properties (Note 5)	87,429,697	90,042,677
Other non-current assets	139,538	149,513
TOTAL ASSETS	$ 231,936,854	$ 241,287,381
LIABILITIES		
Current liabilities		
Trade payables and accrued liabilities	$ 15,718,255	$ 16,635,832
Current portion of long-term debt (Note 6)	21,511,120	10,950,493
	37,229,375	27,586,325
Long-term debt (Note 6)	30,940,321	30,864,165
Restoration provisions	12,223,439	12,485,650
TOTAL LIABILITIES	80,393,135	70,936,140
EQUITY		
Share capital (Note 7)	282,796,453	278,995,472
Contributed surplus (Note 8)	4,832,868	5,769,245
Cumulative deficit	(118,412,076)	(104,243,885)
Accumulated other comprehensive loss	(19,649,656)	(13,200,175)
Total equity attributable to shareholders of the Company	149,567,589	167,320,657
Non-controlling interests (Note 9)	1,976,130	3,030,584
TOTAL EQUITY	151,543,719	170,351,241
TOTAL LIABILITIES AND EQUITY	$ 231,936,854	$ 241,287,381

Contingencies (Note 15)

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

Approved on Behalf of the Board of Directors:

"Paul K. Conibear"
Director

"William Lamb"
Director

LUCARA DIAMOND CORP.
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS
(All amounts expressed in U.S. Dollars, unless otherwise indicated.)
(Unaudited)

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Revenues	$ 12,658,547	$ -	$ 12,658,547	$ -
Cost of goods sold				
Operating expenses	5,540,853	-	5,540,853	-
Royalty expenses	1,265,855		1,265,855	
Depletion, amortization and accretion	2,153,817	-	2,153,817	-
	8,960,525	-	8,960,525	-
Income from mining operations	3,698,022	-	3,698,022	-
Other expenses				
Exploration expenditures (Note 10)	4,464,791	3,116,383	10,576,784	7,183,084
Administration (Note 11)	2,979,850	1,304,914	7,735,893	5,927,640
Gain on sale of diamonds (Note 12)	-	-	-	(2,339,282)
Sales and marketing	665,408	-	665,408	-
Finance expenses (income)	1,338,834	(382,748)	1,739,327	172,362
Foreign exchange loss (gain)	(2,337,782)	1,414,558	(1,829,600)	2,291,714
	7,111,101	5,453,107	18,887,812	13,235,518
Net loss for the period	$ (3,413,079)	$ (5,453,107)	$ (15,189,790)	$ (13,235,518)
Attributable to:				
Shareholders of the Company	$ (2,853,079)	$ (5,033,214)	$ (13,862,688)	$ (12,582,505)
Non-controlling interests	$ (560,000)	$ (419,893)	$ (1,327,102)	$ (653,013)
Basic and diluted loss per common share	$ (0.01)	$ (0.01)	$ (0.04)	$ (0.04)
Weighted average common shares outstanding	376,279,504	370,090,737	374,060,437	355,887,680

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

LUCARA DIAMOND CORP.
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(All amounts expressed in U.S. Dollars, unless otherwise indicated.)
(Unaudited)

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Net loss for the period	$ (3,413,079)	$ (5,453,107)	$ (15,189,790)	$ (13,235,518)
Other comprehensive loss				
Change in fair value of available-for-sale securities	(3,775)	(93,197)	(25,879)	(95,891)
Currency translation adjustment	(2,995,942)	(19,372,229)	(6,456,457)	(18,885,726)
	(2,999,717)	(19,465,426)	(6,482,336)	(18,981,617)
Comprehensive loss	$ (6,412,796)	$ (24,918,533)	$ (21,672,126)	$ (32,217,135)
Comprehensive loss attributable to:				
Shareholders of the Company	(5,845,146)	(24,157,276)	(20,312,169)	(31,156,938)
Non-controlling interests	(567,650)	(761,257)	(1,359,957)	(1,060,197)
	$ (6,412,796)	$ (24,918,533)	$ (21,672,126)	$ (32,217,135)

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

LUCARA DIAMOND CORP.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Cash flows from (used in):				
Operating Activities				
Net loss for the period	$ (3,413,079)	$ (5,453,107)	$ (15,189,790)	$ (13,235,518)
Items not involving cash and cash equivalents:				
Depreciation	2,787,203	924,438	3,943,488	2,098,997
Finance costs	1,143,263	18,122	1,625,219	54,693
Stock-based compensation	56,971	143,196	244,625	419,054
Foreign exchange gain	(3,081,326)	-	(1,919,312)	-
	(2,506,968)	(4,367,351)	(11,295,770)	(10,662,774)
Net changes in working capital items:				
VAT receivables and other current assets	4,533,367	(3,201,488)	2,108,819	(6,149,639)
Inventories	3,712,206	(1,483,178)	(4,736,581)	512,251
Trade payables and other current liabilities	9,871,206	(224,307)	11,337,167	(190,545)
	15,609,811	(9,276,324)	(2,586,365)	(16,490,707)
Financing Activities				
Proceeds from debt	-	50,000,000	-	50,000,000
Drawdown of revolving credit facility	7,000,000	-	7,000,000	-
Proceeds from issue of shares, net of issue costs	-	-	-	58,283,612
Proceeds from exercise of stock options	88,868	346,682	2,619,979	492,536
Other	456,391	-	-	-
	7,545,259	50,346,682	9,619,979	108,776,148
Investing Activities				
Acquisition of plant and equipment	(19,907,226)	(24,497,220)	(44,056,174)	(52,947,767)
Other	-	15,381	-	53,087
	(19,907,226)	(24,481,839)	(44,056,174)	(52,894,680)
Effect of exchange rate change on cash and cash equivalents	131,211	(2,068,420)	(492,208)	(1,534,807)
Increase (decrease) in cash and cash equivalents during the period	3,379,055	14,520,099	(37,514,768)	37,855,954
Cash and cash equivalents, beginning of period	7,695,586	56,220,760	48,589,409	32,884,905
Cash and cash equivalents, end of period	$ 11,074,641	$ 70,740,859	$ 11,074,641	$ 70,740,859
Supplemental Information				
Interest received	21,156	410,779	219,247	564,442
Taxes paid	-	-	-	-
Changes in accounts payable and accrued liabilities related to plant and equipment	(11,997,708)	3,788,048	(12,168,349)	5,157,340
Shares issued in conjunction with the debenture	-	10,663,220	-	10,663,220

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

LUCARA DIAMOND CORP.
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(All amounts expressed in U.S. Dollars, unless otherwise indicated.)
(Unaudited)

	Number of shares issued and outstanding	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive income (loss)	Non-controlling interests	Total
Balance, January 1, 2011	302,494,050	$ 209,210,999	$ 5,421,258	$ (84,121,453)	$ 5,141,321	$ 1,861,184	$ 137,513,309
Private placement, net of share issue costs	60,000,000	58,283,612	-	-	-	-	58,283,612
Bonus shares	9,000,000	10,663,220	-	-	-	-	10,663,220
Exercise of stock options	604,999	691,890	(199,354)	-	-	-	492,536
Stock-based compensation	-	-	419,054	-	-	-	419,054
Unrealized loss on investments	-	-	-	-	(95,891)	-	(95,891)
Effect of foreign currency translation	-	-	-	-	(18,478,542)	(407,184)	(18,885,726)
Net loss for the period	-	-	-	(12,582,505)	-	(653,013)	(13,235,518)
Balance, September 30, 2011	372,099,049	$ 278,849,721	$ 5,640,958	$ (96,703,958)	$ (13,433,112)	$ 800,987	$ 175,154,596
Balance, January 1, 2012	372,349,049	$ 278,995,472	$ 5,769,245	$ (104,243,885)	$ (13,200,175)	$ 3,030,584	$ 170,351,241
Exercise of stock options	3,943,700	3,800,981	(1,181,002)	-	-	-	2,619,979
Stock-based compensation	-	-	244,625	-	-	-	244,625
Effect of foreign currency translation	-	-	-	-	(6,423,602)	(32,855)	(6,456,457)
Unrealized loss on investments	-	-	-	-	(25,879)	-	(25,879)
Free-carried non-controlling interests (Note 9)	-	-	-	(305,503)	-	305,503	-
Net loss for the period	-	-	-	(13,862,688)	-	(1,327,102)	(15,189,790)
Balance, September 30, 2012	376,292,749	$ 282,796,453	$ 4,832,868	$ (118,412,076)	$ (19,649,656)	$ 1,976,130	$ 151,543,719

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

(All amounts expressed in 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 development stage company focused on diamond properties in Africa. The Company holds a 100% interest in the Karowe Mine (previously named AK6 Diamond Project) located in Botswana and a 75% interest in Mothae Diamond Project located in Lesotho.

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

2. BASIS OF PRESENTATION AND CONSOLIDATION

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of interim financial statements, *IAS 34: Interim Financial Statements*, and do not contain all of the information required for annual financial statements. These statements follow the same accounting policies and methods of application of the most recent annual audited financial statements. Accordingly, they should be read in conjunction with the most recent annual audited financial statements of the Company.

These financial statements were approved by the Board of Directors for issue on November 9, 2012.

3. INVENTORIES

	September 30, 2012	December 31, 2011
Rough diamond inventories	$ 5,494,443	$ -
Ore stockpile inventories	186,223	1,597,255
Parts inventories	2,003,644	-
	$ 7,684,310	$ 1,597,255

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

4. PLANT AND EQUIPMENT

Cost	Construction in progress	Mine and plant facilities	Vehicles	Furniture and office equipment	Total
Balance, January 1, 2011	$ 11,495,024	$ 6,800,639	$ 455,111	$ 288,201	$ 19,038,975
Additions	84,164,797	2,412,460	1,017,022	2,268,944	89,863,223
Disposals and other	-	-	-	(8,103)	(8,103)
Translation differences	(8,939,809)	(1,447,211)	(158,333)	(230,021)	(10,775,374)
Balance, December 31, 2011	86,720,012	7,765,888	1,313,800	2,319,021	98,118,721
Additions	27,342,917	7,061,442	169,502	391,442	34,965,303
Disposals and other	871,829	-	(2,088)	(1,141,816)	(272,075)
Translation differences	(2,644,136)	(273,066)	(36,589)	(24,927)	(2,978,718)
Reclassification	(112,290,622)	112,290,622	-	-	-
Balance, September 30, 2012	$ -	$ 126,844,886	$ 1,444,625	$ 1,543,720	$ 129,833,231
Accumulated depreciation					
Balance, January 1, 2011	$ -	$ 1,520,538	$ 2,234	$ 24,164	$ 1,546,936
Depreciation, depletion for the year	-	2,165,316	309,721	166,407	2,641,444
Disposals and other	-	-	-	(690)	(690)
Translation differences	-	(521,490)	(29,572)	(19,152)	(570,214)
Balance, December 31, 2011	-	3,164,364	282,383	170,729	3,617,476
Depreciation, depletion for the period	-	4,609,891	255,198	243,944	5,109,033
Disposals and other	-	-	-	-	-
Translation differences	-	(183,099)	(12,994)	(8,473)	(204,566)
Balance, September 30, 2012	$ -	$ 7,591,156	$ 524,587	$ 406,200	$ 8,521,943
Net book value					
As at December 31, 2011	$ 86,720,012	$ 4,601,524	$ 1,031,417	$ 2,148,292	$ 94,501,245
As at September 30, 2012	$ -	$ 119,253,730	$ 920,038	$ 1,137,520	$ 121,311,288

During the nine months ended September 30, 2012, depreciation of $279,203 (December 31, 2011 – nil) was taken on assets used during the testing and commissioning of the Karowe Mine. This amount has been capitalized to construction in progress.

During the nine months ended September 30, 2012, the Company reduced plant and equipment by $12.8 million relating to diamonds sold during the pre-commercial production period.

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

4. PLANT AND EQUIPMENT (continued)

Plant and equipment include interest and financing costs relating to the construction of plant and equipment prior to the commencement of commercial production. Interest and financing costs are capitalized only for the project for which funds have been borrowed. Interest expense capitalized during the nine months ended September 30, 2012 was $2,526,200 (December 31, 2011 – $1,262,717).

5. MINERAL PROPERTIES

Cost	Karowe Mine	Mothae Diamond	Mothae mining license	Total
Balance, January 1, 2011	$ 64,610,259	$ 20,483,498	$ 4,060,985	$ 89,154,742
Additions	12,959,168	187,518	-	13,146,686
Disposals and other	-	-	-	-
Translation differences	(9,067,150)	(2,445,156)	(746,445)	(12,258,751)
Balance, December 31, 2011	68,502,277	18,225,860	3,314,540	90,042,677
Additions	-	-	-	-
Disposals and other	-	-	-	-
Translation differences	(1,744,611)	(377,972)	(72,758)	(2,195,341)
Balance, September 30, 2012	$ 66,757,666	$ 17,847,888	$ 3,241,782	$ 87,847,336
Accumulated depletion				
Balance, January 1, 2011	$ -	$ -	$ -	$ -
Depletion for the year	-	-	-	-
Disposals and other	-	-	-	-
Translation differences	-	-	-	-
Balance, December 31, 2011	-	-	-	-
Depletion for the period	426,948	-	-	426,948
Disposals and other	-	-	-	-
Translation differences	(9,309)	-	-	(9,309)
Balance, September 30, 2012	$ 417,639	$ -	$ -	$ 417,639
Net book value				
As at December 31, 2011	$ 68,502,277	$ 18,225,860	$ 3,314,540	$ 90,042,677
As at September 30, 2012	$ 66,340,027	$ 17,847,888	$ 3,241,782	$ 87,429,697

5. MINERAL PROPERTIES (continued)

a) Karowe Mine

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

b) Mothae Diamond Project

In July 2006, the Company signed an option agreement with Motapa Diamonds Inc. ("Motapa") to acquire up to a 70% interest in the Mothae Diamond Project located in Lesotho, Africa. Pursuant to the terms of the option agreement the Company earned a 65% interest in the property in April 2009 by making payments to Motapa totaling $8.0 million.

On July 3, 2009, the Company acquired the remaining 35% interest in the property by acquiring Motapa through a plan of arrangement by issuing a total of 34,455,022 shares to the shareholders of Motapa at an exchange ratio of 0.9055 shares ("Exchange Ratio") for each Motapa share. In addition, the Company issued a total of 3,019,835 replacement stock options to the Motapa stock option holders at the same exchange ratio.

Pursuant to the terms of the mining agreement, Mothae Diamonds, an indirect 75% owned subsidiary of the Company has a 100% interest in the project. The remaining 25% of Mothae Diamonds is held by the Government of Lesotho (Note 9). One half of the project interest held by the Government is a free carried interest and one half is funded by the Government through its share of project dividends. During an initial pre-production test mining stage, a royalty of 4% of the sales value of diamonds produced from Mothae will be payable to the government. At full production the royalty will increase to 8% of diamond sales value. The mining lease is valid until September 2019 and renewable for an additional 10 years.

6. LONG-TERM DEBT

a) Debenture

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

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

6. LONG-TERM DEBT (continued)

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

The terms of the debenture financing also included the Company issuing an aggregate of 9 million common shares (fair value $10.7 million) to Zebra and Lorito as consideration for the facility, in lieu of interest and fees. During the period, accretion of $4.1 million was recorded of which $2.5 million has been capitalized in plant and equipment (Note 4).

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

As at September 30, 2012	**Current portion**	**Long-term portion**	**Total**
Principal	$ 25,000,000	$ 25,000,000	$ 50,000,000
Unamortized discount	(3,192,074)	(911,787)	(4,103,861)
Total carrying value	$ 21,807,926	$ 24,088,213	$ 45,896,139

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

b) Revolving credit facility

In April 2012, the Company signed a definitive agreement with the Bank of Nova Scotia for a $25 million revolving term credit facility with a maturity date of March 26, 2014, which may be extended if both parties agree. Funds drawn under the revolving credit facility are due in full at maturity. 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 will provide security on the two year facility by way of a charge over the Company's Karowe assets and a guarantee by the Company's subsidiaries, which hold the Karowe assets.

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

As at September 30, 2012, the Company has drawn $7.0 million from the credit facility which is netted against deferred finance charges relating to the set-up of the facility of $0.4 million.

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

7. SHARE CAPITAL

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

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

In July 2011, 9.0 million common shares with a fair value of $10.7 million were issued Zebra and Lorito as consideration for the $50.0 million debenture (Note 6).

8. STOCK OPTIONS

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

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

	Number of shares issuable pursuant to stock options		Weighted average exercise price per share (CDN$)
Balance at January 1, 2011	**11,550,000**	**$**	**0.91**
Granted	1,525,000		0.84
Forfeited	(168,330)		0.95
Expired	(20,000)		0.77
Exercised	(854,999)		0.71
Balance at December 31, 2011	**12,031,671**		**0.93**
Granted	150,000		1.03
Forfeited	(391,671)		0.90
Expired	(3,531,300)		1.19
Exercised	(3,943,700)		0.70
Balance at September 30, 2012	**4,315,000**	**$**	**0.93**

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

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

8. STOCK OPTIONS (continued)

Options to acquire common shares have been granted and are outstanding at September 30, 2012 as follows:

	Outstanding Options			Exercisable Options		
Range of exercise prices CDN$	Number of options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price CDN$	Number of options exercisable	Weighted average remaining contractual life (years)	Weighted average exercise price CDN$
$0.00 - $0.99	2,390,000	1.6850	0.87	1,334,920	1.4239	0.88
$1.00 - $1.49	1,925,000	0.2957	1.01	1,883,331	0.2528	1.00
	4,315,000	1.0652	$ 0.93	3,218,251	0.7386	$ 0.95

During the nine months ended September 30, 2012, an amount of $244,625 (2011 – $419,054) 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:

	September 30, 2012	December 31, 2011
Assumptions:		
Risk-free interest rate *(%)*	1.03	1.12
Expected life *(years)*	3.00	3.00
Expected volatility *(%)*	51.23	57.95
Expected dividend	Nil	Nil
Results:		
Weighted average fair value of options granted *(per option)*	$ 0.35	$ 0.32

9. NON-CONTROLLING INTERESTS

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

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

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

10. EXPLORATION EXPENDITURES

	Three months ended September 30, 2012			Three months ended September 30, 2011		
	Mothae Diamond	Other	Total	Mothae Diamond	Other	Total
Test mining	$ 2,879,834	$ -	$ 2,879,834	$ 3,181,877	$ -	$ 3,181,877
Depreciation	596,729	-	596,729	918,893	-	918,893
Geology	161,573	-	161,573	-	-	-
Office and other	164,050	-	164,050	202,205	-	202,205
Resource development	244,432	-	244,432	193,349	-	193,349
Diamonds recovered	418,173	-	418,173	(1,379,941)	-	(1,379,941)
	$ 4,464,791	$ -	$ 4,464,791	$ 3,116,383	$ -	$ 3,116,383

	Nine months ended September 30, 2012			Nine months ended September 30, 2011		
	Mothae Diamond	Other	Total	Mothae Diamond	Other	Total
Test mining	$ 7,737,540	$ -	$ 7,737,540	$ 8,605,709	$ -	$ 8,605,709
Depreciation	1,680,469	-	1,680,469	2,093,457	-	2,093,457
Geology	585,188	-	585,188	-	-	-
Office and other	446,586	-	446,586	492,171	7,831	500,002
Resource development	1,455,442	-	1,455,442	251,817	-	251,817
Diamonds recovered	(1,328,441)	-	(1,328,441)	(4,267,901)	-	(4,267,901)
	$ 10,576,784	$ -	$ 10,576,784	$ 7,175,253	$ 7,831	$ 7,183,084

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

11. ADMINISTRATION

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Salaries and benefits	$ 905,621	$ 349,507	$ 3,381,511	$ 1,095,813
Stock exchange, transfer agent, shareholder communication	946,707	181,170	1,489,383	1,180,351
Professional fees	368,885	272,859	828,345	1,446,646
Management fees	126,580	134,894	377,093	376,464
Travel	260,006	161,576	529,127	579,418
Stock-based compensation (Note 8)	56,971	143,196	244,625	419,054
Office and general	278,423	62,072	757,718	216,094
Depreciation	36,657	-	109,202	-
Donations	-	(360)	18,889	613,800
	$ 2,979,850	$ 1,304,914	$ 7,735,893	$ 5,927,640

12. GAIN ON SALE OF DIAMONDS

During the three months ended September 30, 2012, Mothae Diamonds held one diamond sale and received gross proceeds of 1.5 million. The proceeds on this sale have been netted against exploration expenditures (Note 10).

During the nine months ended September 30, 2011, Mothae Diamonds held one diamond sale and received net proceeds of $7.5 million (after payment of royalties and selling costs). The sale included the rough diamond inventory that was held at December 31, 2010, which was valued using the Company's best estimate of the lower of cost and net realizable value. The Company recorded a gain relating to the increase in the value of the rough diamond inventory held at December 31, 2010 of $2,339,282 in the Statement of Operations. The proceeds relating to the sale of diamonds recovered during the nine months ended September 30, 2011 have been netted against exploration expenditures (Note 10).

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

13. RELATED PARTY TRANSACTIONS

a) Related party expenses

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

Description of services	**Related party**	**Nine months ended September 30, 2012**	**2011**
Management fees	Namdo	$ 377,093	$ 376,464
Donations	LF	-	613,800
Exploration related expenditures	MS Group	1,587,492	-
Aircraft charter	Mile High	368,760	306,605
		$ 2,333,345	$ 1,296,869

b) Related party liabilities

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

	September 30, 2012	**December 31, 2011**
Mile High	$ 264,745	$ -
	$ 264,745	$ -

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

13. RELATED PARTY TRANSACTIONS (continued)

c) *Key management compensation*

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

The remuneration of key management personnel were as follows:

	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Salaries and wages	$ 1,855,250	$ 932,273
Short term benefits	45,415	99,667
Stock-based compensation	158,989	339,769
	$ 2,059,654	$ 1,371,709

14. SEGMENT INFORMATION

The Company's primary business activity is the exploration and development of diamond properties in Africa so there is only one reportable operating segment.

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

	Plant and equipment		Mineral properties		Other	
	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011
Canada	$ 226,181	$ 259,925	$ -	$ -	$ -	$ 7,766
Lesotho	3,003,513	4,751,648	21,089,670	21,540,400	139,538	141,747
Botswana	118,081,594	89,489,672	66,340,027	68,502,277	-	-
	$121,311,288	$94,501,245	$87,429,697	$90,042,677	$ 139,538	$ 149,513

Note 10 contains the geographic distribution of exploration expenditures, which are all incurred in Lesotho.

15. CONTINGENCIES

In April 2010, legal proceedings were initiated against African Diamonds (Plc) ("AFD"), a subsidiary acquired by the Company in 2010. Legal proceedings were instituted by two former directors of AFD in respect of a Joint Venture Agreement (the "Agreement") entered into during 2002. The Plaintiffs alleged that the Karowe Mine fell within the Project Area as defined in the Agreement and alleged entitlement to a 3% royalty of the Net Smelter Return on any production from the Karowe Mine for the first ten years of production.

The claim was heard in the Botswana High Court in early June 2011. Judgment in respect hereof was handed down in August 2011 in favor of AFD and dismissed the Plaintiff's claim with costs.

In September 2011, the Plaintiffs, now referred to as the Appellants, filed a Notice of Appeal in respect of the judgment. The Appellants requested an order setting aside the judgment in August 2011.

The case went to the High Court in Botswana on April 19, 2012 in order to set the record of appeal. The Parties are still waiting on confirmation from the Registrar of the Appeal Court on when the Appeal is to be heard.

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