

Paragon Diamonds

Speculative Buy

Price: 5.55p-6p

EPIC: PRG.L (FTSE AIM All Share)

Sector: Mining

Emerging Diamond Producer

With Polished Upside

Fully Funded

Paragon Diamonds will own 80% of the Lemphane kimberlite pipe project located in Lesotho, once production commences.

Having raised \$12m from a middle east investor,* Paragon is fully funded to mobilise the Lemphane Diamond project to stage 1 production in Q2 2015. This will allow it to determine the grade and average value of diamonds at the project. It will then seek to move the project to Stage 2 production.

Stage 1 will involve the extraction of approximately 1 million tonnes of kimberlite over two years and according to an independent report, is expected to lead to the recovery of over 100 diamonds larger than 9 carats, including some stones over 100 carats in size.

The design of the plant has been finalised and construction has commenced, including ordering of key long lead time items, ensuring minimal down time between now and the commencement of Stage 1 production.

The Investor* has confirmed that it will support Paragon with an additional loan should any suitable opportunities to acquire a proven diamond resource arise. The Company is currently evaluating strategic opportunities within Africa.

Share price performance



Source: London Stock Exchange

Key Data

No. of shares:	276m
Mkt. cap:	£15.4m
Website:	paragondiamonds.com

*The Investor

International Triangle General Trading LLC (ITGT)

ITGT is a privately owned international investment group, with a focus on construction, automobiles, real estate and banking. ITGT was established in 1991 and is based in Dubai, the wider Middle East and China.

Operations Update

Design work has been concluded on the planned 75tph (0.5Mt/yr) process plant for Stage 1 Production at Lemphane, metallurgical test work is being concluded, and long-lead-time item procurement has been undertaken ahead of fabrication of the main plant components. Long lead-time items include scrubbers, crushers, x-ray transmission recovery machines and water recovery thickeners. The Company has also finalized provisional tailings storage facilities (TSF) designs with its civil engineers, and the terms for contract mining for Stage 1.

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Site clearance for the new plant has been undertaken, and civil construction activities are planned to commence in the coming weeks. Discussions are also well advanced with the national power company's main contractor, for access to the privately funded open-access power line (presently nearing completion) for electrical supply to the mine. Discussions have also been finalised with the providers of camp accommodation and services, and security.

Separately, the Company's geological consultants, MSA Group, have been instructed regarding ongoing work on the geological model, to be updated in light of recent, positive drilling results, and concerning updating of the present scoping study to a full feasibility study over the course of Stage 1 mining activity, which will be a work in progress.

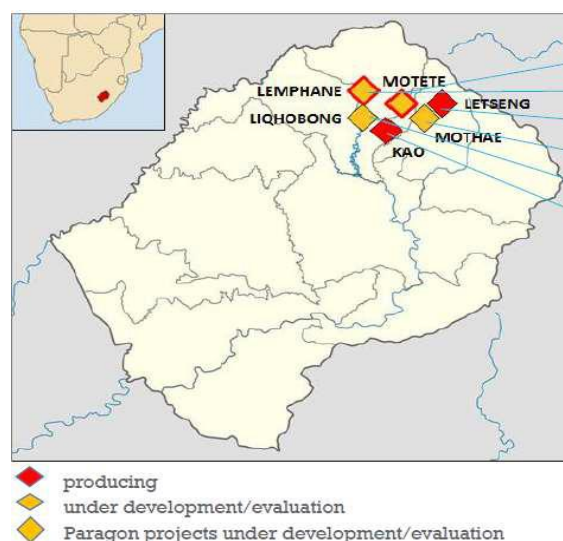
Stage 1 production will cover a two year period during which approximately 1 Mt of kimberlite will be mined and processed out of the currently estimated 48.6Mt of kimberlite (to 350m depth) at the site, using a 75 tonne per hour processing plant. The Company is targeting 20,000 carats during Stage 1 production with an estimated minimum value of US\$930 per carat that is expected to generate revenues in excess of US\$9m per annum. Cash flow will be reinvested to further develop Lemphane and complete a bankable feasibility study, a 3D geological model and a substantial inferred resource ahead of commencing the Stage 2 production phase. Stage 2 will see production ramped up to 3Mt/year with peak production expected to hit 65,000 carats per year of high value diamonds. The company estimate \$1,500 per carat.

It is the intention of the Company to become a fully integrated diamond company maximizing the margins gained from being exposed from the mining to selling of diamonds.

Lemphane, Lesotho

The Lemphane project is the last undeveloped commercial diamond bearing kimberlite pipe known in Lesotho. Producing mines within Lesotho currently include Gem Diamonds' (GEM.L) Letšeng Mine and Namakwa Diamonds' (private) Kao. Firestone Diamonds (FDI.L) is currently developing a commercial mine at Liqhobong and Lucara Diamond Corp.'s (LUC.TSX). See map below.

Mothae project has been put up for sale. Paragon, by virtue of 'following' the early developers, can piggy-back into the existing infrastructure, with spurs to their mine for final connections and delivery.



Location of diamond bearing kimberlite pipes in Lesotho

Paragon's 80% subsidiary (20% Government of Lesotho) holds a mining lease for the Lemphane project for ten years from February 2014 and is extendable for a further thirty years. There is an initial royalty of 4% that will be payable to the Government on the commencement of production and is subject to review within five years.

ITGT will subscribe for 98m shares in Paragon at a price of 5.5p per share, raising \$8.09m. Paragon will also issue a \$4m secured loan note to ITGT. This note will have a three year term and a 10% per annum coupon payable annually.

The Diamond Market

Demand

Management believe global demand for diamonds is expected to exceed growth in supply for a number of years to come.

On the demand side, over the next ten years high jewellery demand is expected to grow at a compound annual rate of 6% driven by increased demand from China and India. As well as traditional demand for diamonds for use in jewellery, management believe there is significant potential for diamonds to emerge as an investment asset class providing investors with an alternative store of wealth to gold.

Global wealth is estimated by Credit Suisse to increase by 40% to \$369tr from \$263tr over the next five years, equivalent to a CAGR of 7%. At the macro level, this large increase in wealth will drive increased consumer demand for diamond bearing jewellery that will in turn drive demand for rough stones.

Emerging markets are likely to see diamond demand continue to grow at a pace that outstrips those of the established markets with the expansion of the middle classes as the countries move from producer to consumer societies. Forecast CAGR for rough and diamond jewellery demand is expected to grow between 4.7% and 6.4%. **

** Bain & Company Inc, Rio Tinto, Bank of America Merrill Lynch, Alrosa and De Beers

Supply

Based on the range of forecasts (Bain & Company Inc, Rio Tinto, Bank of America Merrill Lynch) and McKinsey & Co), diamond supply is likely to continue to increase in the near to medium-term, with a gradual decline over the medium to long-term assuming no new significant discoveries are made.

On the supply side, investment in new projects is required to maintain current production levels. Together with "new" production increasingly coming from underground operations associated with higher costs, and the majority of diamond revenues being generated by a small amount of large diamonds, security of supply is becoming a key price driver in the diamond industry.

With no immediate new supplies coming on stream, demand set to rise and strong growth from emerging markets, diamond prices appear well underpinned going forward.

Management

One of the single most important criteria in selecting investments is the management. The Executive Chairman is an impressive individual with a desire to see Paragon as a fully integrated and unique Diamond business:

Philip Falzon Sant Manduca**Executive Chairman**

Philip Falzon Sant Manduca is Chief Executive Officer of Titanium Capital Group, a venture capital and private equity investment group of companies, focused on executing strategic hard asset investments. He has achieved capital gains for shareholders through the realisation of enterprise value growth in a number of asset management businesses over the last 25 years. His vision for the company is to expand Paragon Diamonds into a vertically integrated diamond company, controlling the production, manufacturing, polishing, investment fund and retail distribution of diamonds, which he expects to continue to significantly increase in value in both the near and long term.

Stephen Grimmer**Managing Director**

Stephen Grimmer holds a PhD in geology from Keele University and an MSc from the Royal School of Mines. He has worked in senior management roles in the diamond industry since 1988, in Angola, Southern and West Africa, South America, Scandinavia and Russia. In his career he has planned and/or built a number of diamond mines, both alluvial and kimberlite, and managed several advanced kimberlite evaluation projects. He also has extensive exploration, mining and production experience gained working for a number of major private producers and London/Toronto listed companies.

Simon Retter**Finance Director**

Simon Retter read accounting and finance at Bristol University, after which he joined Deloitte LLP and qualified as a chartered accountant. He specialised in resources focused corporate finance transactions including numerous LSE market flotations, extractive industries accounting, finance and internal controls assurance. During his time at Deloitte he advised numerous African based resource companies. Simon has also provided financial consulting services for London listed companies with overseas operations.

Martin Doyle**Non-Executive Director**

Martin began his career with Anglo American in 1977 as a field geologist conducting diamond exploration in Botswana and he has worked in many other parts of the world in progressive roles for De Beers and Anglo American. These roles include the pioneering evaluation of marine diamond deposits and the development of seabed mining systems for De Beers Marine in South Africa; the exploration and investigation of seabed gold deposits in Chile; managing exploration research and support services for Anglo American in South Africa before returning to diamond exploration for De Beers in Brazil, Uruguay and Venezuela. Martin graduated in 1977 with a BSc (Hons) Geology from the University Of Aberdeen, Scotland and in 1987 graduated with an MBA from the University of Cape Town, South Africa. He is a Registered Professional Geologist (P.Geo) of the Association of Professional Geoscientists of Ontario (APGO), a Fellow of the Society of Economic Geologists (SEG), a Director of Debut Diamonds (DDI), A Director of the Prospectors and Developers Association of Canada (PDAC) and a Director of the Canadian Mining Innovation Council (CMIC).

Conclusion

The new management team have been busy. They have invested significant amounts in the company, brought in a valuable shareholder at the current price and raised enough cash to fund development for two years. The Dubai investor is prepared to back further acquisitions.

With production planned as early as the second quarter in 2015, we envisage cash flow will be reinvested

to further develop Lemphane and complete a bankable feasibility study, a 3D geological model and a substantial inferred resource ahead of commencing the Stage 2 production phase.

But there is the added potential of benefiting from participating in the polished market, by receiving income from their mined diamonds at the final sale point.

This is a stock to buy and put away as we believe this is the beginning of a potentially rewarding investment. **Speculative Buy**

Strengths and Weaknesses

Strengths

- *Successful fund raise of circa \$12m with Dubai investor*
- *Unique 'fully' integrated diamond company*
- *Early revenues anticipated*

Weaknesses

- *Implementation of plans may be delayed*
- *Carat size may not be as expected*
- *Diamond Price falls will affect economics*

Sources: Company website, RNS announcements, Proquote.

Recommendations

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Company Name	Disclosure
Paragon Diamonds	N/A

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