PARAGON DIAMONDS Limited

INTERIM FINANCIAL STATEMENTS 2015

PARAGON DIAMONDS LIMITED

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I am delighted to report on the substantial progress we have made during 2015 as we deliver on our objective to transform Paragon into a leading vertically integrated diamond house. We shortly expect to have two potentially large stone and high value diamond assets located in Lesotho within our portfolio: our existing flagship project, the 48Mt Lemphane Kimberlite Pipe Project ('Lemphane'); along with signed contracts and approval from the Government of Lesotho to acquire the 39Mt Mothae Kimberlite Pipe Project ('Mothae') from Lucara Diamond Corporation ('Lucara'), which we expect to complete following finalisation of funding.'

We are not just building a diamond production company. Our vision greatly exceeds this as we are looking to become a leading international diamond company, which retains ownership of a diamond from the mine (source) through the manufacturing phase all the way to the sale of diamonds downstream to the consumer and investment markets. We are adopting this approach to ensure as much value as possible is retained for Paragon and its shareholders. With this in mind, once Paragon has moved into first production at Mothae and secondly at Lemphane, we will move forward with our vertically integrated business model through the use of vehicles such as JVs, SPVs and offtake agreements with suitable partners. In addition to integrating vertically, there are also a number of lateral opportunities which could potentially be very profitable for Paragon in the future which we will look to explore. For example diamond investment vehicles for investors looking for exposure to hard assets and commodity currencies. Lastly, should another exciting near-term production asset become available with the right large stone/high value economics, we could add further to our existing asset base.

As I have previously cited, the rationale for our vertically integrated business model is supported by our belief in diamonds as the optimal monetary investment choice and portable store of wealth. Investment grade diamonds are increasingly replacing gold and silver, real estate, art and cars as the monetary commodity asset and store of value providing safety against the risks associated with geopolitical crises, accelerating paper currency debasement, deteriorating global government fiscal balances, rising wealth taxes and negative bond yields. One of diamonds' USPs is that they are portable, are outside of any banking system and are internationally tradeable with any currency. Moreover the structural change taking place in the diamond sales market, specifically in terms of price transparency as a result of wider electronic transmission and the use of tenders, auctions and private placement is forcing transactions to migrate away from centres such as Antwerp. These two factors in my mind creates a significant opportunity for a vertically integrated company whilst exploiting an ongoing secular shift within the diamond sector, which is changing the distribution and retail landscape along with the geography of diamond sales.

Operations

Mothae

In May 2015, we signed a Memorandum Of Understanding ('MOU') with Lucara to acquire a 75% equity stake in the Mothae Kimberlite mine. Mothae is only 5 km from the world class Letšeng diamond mine in Lesotho that is located within a cluster of kimberlites, including Paragon's Lemphane Kimberlite Pipe Project ('Lemphane'). This is a transformational deal that will increase our diamond producing capabilities to over 100,000cts when at full production with an average value over US$1,500/ct (at recent prices) and indeed should re-rate our business model and valuation in the market.

We have approval from the Government of Lesotho in hand and we are just waiting to finalise the acquisition with Lucara, which has granted an extension of seven days on the original 30 September deadline to enable the conclusion of the transaction.

Mothae has a NI 43-101 compliant 39Mt Indicated and Inferred Mineral Resource Estimate with a 2.72 cpht grade and value of US$1,034/ct. The mine has the potential to hold 100+ carat stones, and our current mine plan for an initial 25 million tonne mine includes a minimum in-situ value of US$867m from the potential US$1,097m available; an initial NPV of US$115m (discounted at 12%), is forecast to generate US$60+million annual revenues over a minimum 12 years of full production, based on management's preliminary internal model. The project already has extensive infrastructure in place, including a nominal 75tph (0.5Mt/yr) processing plant, workshops, diesel-generated power supply, accommodation camp, offices, water dams and TSF exists on site and forms part of the acquisition.

It is our intention to fast-track Mothae into substantial production by using and upgrading the existing 75 tonne per hour trial mining plant. Production can be re-established at minimal cost within a four to six month period, at a rate exceeding 100tph and once established, development will commence on a full-scale 300tph+ long-term main production facility which is earmarked to be operational and producing within 18 months of initiation. Production will initially be concentrated on the most economic higher-grade/higher-value, low waste: ore ratio Southwest/Southcentral resource, which is believed to exceed 25Mt and over 0.7Mcts.

Furthermore, this portion of the resource follows a large diamond/high grade mine model and has the potential to host circa 15% of carats as diamonds in excess of 10 carats, and 2% of carats in diamonds in excess of 100 carats. The highest value diamond recovered from Mothae to date has been a 56.5 carat diamond valued at over US$37,000 per carat in December 2011, and the single highest diamond value achieved was US$57,000 per carat for a 28.9 carat stone also in December 2011.

In September 2015 results from technical studies undertaken on the Mothae resource by the Company's consultants exceeded our initial expectations, and confirm that it represents a low cost opportunity for Paragon to generate significant value for shareholders through the potential recovery of large high value diamonds. The reports show an improved strip ratio of <1:1 compared to initial estimates of <1.5:1 and the potential for average diamond values up to c. US$2,000/ct. There are several mining scenarios exceeding 20Mt at US$40+/t ore value in a low operating cost mine.

Lemphane

As I discussed in my last Chairman's statement in June 2015, Lemphane, where we hold an 80% interest in the project with the Government of Lesotho holding the remaining 20% will be developed concurrently with Mothae with a view of first production after Mothae in 2016.

The current 48Mt kimberlite deposit where we have a Mining Lease secured, development and production will be staged in two phases. Stage 1 being a two-year mine plan processing 1Mt of kimberlite targeting 20,000 carats (2,500 carats per quarter) with an average value forecast to be US$930-US$1,025 per carat, generating individual annual revenues of approximately US$9m-US$10m for the Company. This will then be followed by an eight year Stage 2 mine plan of approximately 3,000,000 tonnes per annum for an initial open pit life of fifteen years with peak production of 65,000 carats per year.

We believe Lemphane is potentially a similar large high value deposit as Gem Diamond's Letšeng Mine with the potential for at least one +100 carat diamond to be discovered per 1Mt of kimberlite processed with forecast diamond values of between US$930/carat and US$1,025/carat. Size frequency indicates 12% of carats of diamonds could potentially exceed 9 carats. Based on these results, Stage 1 production is currently forecast to recover in excess of 100 diamonds larger than 9 carats, including some stones up to 100 carats in size. Over the entire 48.6Mt of kimberlite delineated by drilling to date, our forecasts predict approximately 50 diamonds in excess of 100 carats and 175 diamonds in excess of 50 carats (i.e. two to three a year and one a month respectively if mined at 3Mt/yr), including diamonds of over 300 carats in size, being recovered.

We already have the design and order plans for a state of the art 75 tonne per hour (0.5Mt/yr.) processing plant at Lemphane which will use the latest X-Ray Transmission (XRT) diamond recovery technology. This will reduce both capital and operating costs at Lemphane, improve diamond recovery, and as a result significantly enhance the project's economics. During the period under review we began to order the long-lead items such as scrubbers, crushers, x-ray transmission recovery machines and water recovery thickeners for the plant. We have also finalised provisional tailings storage facilities (TSF) designs with our civil engineers, and the terms for contract mining for Stage 1. Site clearance for the new plant has also been undertaken. Discussions have also been held 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 and with the providers of camp accommodation and services, and security.

We have begun sourcing and construction of primary crushers, pre-treatment (scrubbing/screening) section, coarse diamond recovery section including XRT and secondary crushing, DMS, Final recovery building, thickeners and we can now commence the civil construction activities.

Funding update

The Company is concluding funding for both of the diamond projects for stage one production, which is expected to be announced as soon as practicable. In addition, and in a very positive statement of confidence in the value of our assets, the Company has also received a formal letter of commitment from a separate investment partner for the majority of the stage two financing requirement for both projects on attractive terms. The Company will update shareholders as appropriate.

To remove any concerns amongst shareholders, the Company has agreed an extension of the £500,000 loan facility due on 30 September until the 7 October (with the option to extend until 14 October) to ensure that financing contracts can be properly concluded over the coming days, if necessary. Lucara have also confirmed their intention to extend the exclusivity period until 7 October to enable the successful completion of the acquisition of Mothae.

Financial Results

The group has focussed on completing funding to advance Lemphane and acquire and advance Mothae over the period and updates will be made as soon as further progress has been made.

The Group generated a loss after tax of £0.5 million during the first half (H1 2014: loss of £0.5 million). In order to ensure as much funds as possible are invested in the ground, administration costs continue to be tightly controlled and amounted to £0.3 million during the six months under review (H1 2014: £0.4 million).

The Group held cash of £0.4 million as at 30 June 2015 (H1 2014: £0.1 million).

The Group had net assets of £23.3 million as at 30 June 2015, (2014: £29.9 million) and intangible exploration assets are carried at £32.6 million (2014: £39.6 million). Group borrowings totalled £3.2 million at 30 June 2015 (2014: £2.1 million).

Overview

I am optimistic about the future of the investment grade diamond sector and strongly believe that, with the addition of Mothae to our existing Lemphane kimberlite project, we are very well positioned to benefit from all the macro fundamentals affecting the diamond industry that are moving in our favour. This includes the anticipated supply constraint, increase in appetite for the larger investment grade stones, which we will be focusing predominantly on, constant advances in technology, lower capital costs and operation synergies from being last mover in an established diamond district, Lesotho. With near-term production, these are exciting times ahead for the Company.

Finally I would like to thank the Board, management and staff, for their hard work not just over the last six months but for the progress we have made in bringing two potentially high-margin assets into production. I would also like to thank shareholders for their patience. It has not been easy to navigate a funding requirement in the depressed emerging market, commodity and mining sectors. I look forward to working with the Paragon team during what promises to be an exciting period for Paragon Diamonds, and with the Government of Lesotho, who consistently evidence their support to us, as we look to deliver on our objectives and generate value for all our shareholders.

Philip Falzon Sant Manduca
Executive Chairman

29 September 2015

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the six months ended 30 June 2015

	Notes	Six Months to 30 June 2015 (Unaudited)	Six Months to 30 June 2014 (Unaudited)	Year to 31 December 2014 (Audited)
Continuing operations		£000	£000	£000
Administration costs		(328)	(395)	(760)
Fair value loss in remeasuring derivative instrument		–	(108)	(252)
Finance costs		(154)	(30)	(30)
Impairment of intangible assets		–	–	(12,310)
LOSS BEFORE TAXATION		(482)	(533)	(13,352)
Taxation		–	–	3,077
LOSS FOR THE PERIOD		(482)	(533)	(10,275)
Attributable to:				
Owners of the parent		(287)	(533)	(8,893)
Non-controlling interest		(195)	–	(1,382)
		(482)	(533)	(10,275)
Other comprehensive income:				
Exchange differences on translation of foreign operations		(867)	(1,107)	1,161
TOTAL COMPREHENSIVE INCOME FOR THE PERIOD		(1,349)	(1,640)	(9,114)
Attributable to:				
Owners of the parent		(1,239)	(1,836)	(7,645)
Non-controlling interest		(110)	196	(1,469)
		(1,349)	(1,640)	(9,114)

LOSS PER SHARE				
From continuing operations				
Basic and diluted (pence)	4	(0.17)	(0.18)	(3.29)

The loss in the current period arises from the Group's continuing operations.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

As at 30 June 2015

	Share capital £000	Share premium £000	Convertible loan reserve £000	Foreign exchange reserve £000	Share based payment reserve £000	Retained deficit £000	Total £000	Non–controlling Interests £000	Total equity £000
AT 1 JANUARY 2014	2,886	47,168	–	(1,828)	664	(21,196)	27,694	3,219	30,913
Loss for the period	–	–	–	–	–	(533)	(533)	–	(533)
Exchange differences on translation of foreign operations	–	–	–	(1,331)	–	–	(1,331)	224	(1,107)
Total comprehensive income for the period	–	–	–	(1,331)	–	(533)	(1,864)	224	(1,640)
Issue of shares	425	925	–	–	–	–	1,350	–	1,350
Purchase of non–controlling interest	–	–	–	–	–	–	–	(773)	(773)
Share based payment	–	–	–	–	77	–	77	–	77
AT 30 JUNE 2014	3,311	48,093	–	(3,159)	741	(21,729)	27,257	2,670	29,927
Loss for the period	–	–	–	–	–	(8,360)	(8,360)	(1,382)	(9,742)
Exchange differences on translation of foreign operations	–	–	–	2,579	–	–	2,579	(311)	2,268
Total comprehensive income for the period	–	–	–	2,579	–	(8,360)	(5,781)	(1,693)	(7,474)
Issue of shares	(556)	303	–	–	–	–	(253)	–	(253)
Expenses on issue of shares	–	(65)	–	–	–	–	(65)	–	(65)
Cancelation of shares	–	(65)	–	–	–	(1,260)	(1,325)	–	(1,325)
Convertible loans issued	–	–	858	–	–	–	858	–	858
Purchase of non–controlling interest	–	–	–	–	–	1,187	1,187	(882)	305
Issue of shares to non–controlling interest	–	–	–	–	–	–	–	2,466	2,466
Share based payment	–	–	–	–	28	–	28	–	28
AT 31 DECEMBER 2014	2,755	48,266	858	(580)	769	(30,162)	21,906	2,561	24,467
Loss for the period	–	–	–	–	–	(287)	(287)	(195)	(482)
Exchange differences on translation of foreign operations	–	–	–	(952)	–	–	(952)	85	(867)
Total comprehensive income for the period	–	–	–	(952)	–	(287)	(1,239)	(110)	(1,349)
Issue of shares	24	107	–	–	–	–	131	–	131
Expenses on issue of shares	–	(3)	–	–	–	–	(3)	–	(3)
Share based payment	–	–	–	–	24	–	24	–	24
AT 30 JUNE 2015	2,779	48,370	858	(1,532)	793	(30,449)	20,819	2,451	23,270

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 June 2015

	Notes	30 June 2015 (Unaudited)	30 June 2014 (Unaudited)	31 December 2014 (Audited)
ASSETS				
NON-CURRENT ASSETS				
Intangible exploration and evaluation assets	5	32,602	39,546	33,438
Derivative financial asset		–	260	–
Property, plant and equipment		131	307	221
TOTAL NON-CURRENT ASSETS		32,733	40,113	33,659
CURRENT ASSETS				
Trade and other receivables		109	125	115
Inventory		11	37	11
Derivative financial asset		–	687	–
Cash and cash equivalents		328	64	92
TOTAL CURRENT ASSETS		448	913	218
TOTAL ASSETS		33,181	41,026	33,877
LIABILITIES				
CURRENT LIABILITIES				
Trade and other payables		(403)	(248)	(326)
TOTAL CURRENT LIABILITIES		(403)	(248)	(326)
NON-CURRENT LIABILITIES				
Site restoration provision		(105)	(113)	(113)
Loans	7	(3,181)	(2,082)	(2,547)
Deferred tax liability		(6,222)	(8,656)	(6,424)
TOTAL NON-CURRENT LIABILITIES		(9,508)	(10,851)	(9,084)
TOTAL LIABILITIES		(9,911)	(11,099)	(9,410)
NET ASSETS		23,270	29,927	24,467
EQUITY				
Share capital	8	2,779	3,311	2,755
Share premium	9	48,370	48,093	48,266
Foreign exchange reserve		(1,532)	(3,159)	(580)
Share based payment reserve		793	741	769
Convertible loan reserve		858	–	858
Retained deficit		(30,449)	(21,729)	(30,162)
Equity attributable to the owners of the parent		20,819	27,257	21,906
Non-controlling interests	6	2,451	2,670	2,561
TOTAL EQUITY		23,270	29,927	24,467

Approved by the board and authorised for issue on 29 September 2015

Philip Falzon Saint Manduca
Executive Chairman

Simon Retter
Finance Director

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

For the six months ended 30 June 2015

	Six Months to 30 June 2015 (Unaudited)	Six Months to 30 June 2014 (Unaudited)	Year to 31 December 2014 (Audited)
OPERATING ACTIVITIES			
Loss before taxation	(482)	(533)	(10,275)
Adjustment for:			
Interest expense	139	30	30
Foreign exchange losses	54	(58)	174
Share based payment charge	24	77	105
Decrease in trade and other receivables	6	6	16
Decrease in inventory	–	1	27
(Decrease)/Increase in trade and other payables	79	18	96
Impairment of intangible assets	–	–	9,232
Fair value loss on remeasuring derivative asset	–	108	252
NET CASH OUTFLOW FROM OPERATIONS	(180)	(351)	(343)
INVESTING ACTIVITIES			
Purchases of property, plant and equipment	–	–	–
Expenditure on mining licences	(211)	(182)	(259)
NET CASH OUTFLOW FROM INVESTING ACTIVITIES	(211)	(182)	(259)
FINANCING ACTIVITIES			
Proceeds from issue of share capital	130	50	–
Expenses of issue of share capital	(3)	–	(65)
Purchase of own share capital	–	–	(1,890)
Proceeds from derivative financial instrument	–	327	1,106
Proceeds from/(repayment) of loan	500	(7)	1,317
NET CASH INFLOW FROM FINANCING ACTIVITIES	627	370	468
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	236	(163)	(134)
Cash and cash equivalents at beginning of period	92	226	2236
Effects of foreign exchange	–	1	–
CASH AND CASH EQUIVALENTS AT END OF PERIOD	328	64	92

NOTES TO THE INTERIM FINANCIAL STATEMENTS

For the six month period ended 30 June 2015

1. BASIS OF PREPARATION

The interim financial statements of Paragon Diamonds Limited are unaudited condensed consolidated financial statements for the six months to 30 June 2015. These include unaudited comparatives for the six month period to 30 June 2014 and those audited for the year ended 31 December 2014.

2. SIGNIFICANT ACCOUNTING POLICIES

The condensed consolidated financial statements have been prepared under the historic cost convention except for the revaluation of certain financial investments and financial assets and liabilities which are included at fair value.

The accounting policies adopted are consistent with those found in the preparation of the Group's annual financial statements for the year ended 31 December 2014.

The condensed consolidated financial statements do not constitute statutory accounts. The statutory accounts for the period to 31 December 2014 have been reported on by the Company's auditors and included an emphasis of matter regarding going concern.

3. SEGMENTAL REPORTING

The board of directors are the chief operating decision maker. The group operates within one segment with operations in south and East Africa. The costs of these operations are being capitalised to the intangible exploration and evaluation asset as all projects are at an early stage of development. The administration costs are incurred in Guernsey in relation to the Head office function and are expensed through the income statement.

4. LOSS PER SHARE

Basic loss per share is based on the net loss for the period of £482,000 (2014: £445,000) attributable to equity holders of the parent divided by the weighted average number of ordinary shares in issue during the period of 276,969,099 (2014: 298,793,068).

5. INTANGIBLE EXPLORATION AND EVALUATION ASSETS

	Exploration licences £000
COST AND BOOK VALUE AT 1 JANUARY 2014	40,635
Exploration costs capitalised	281
Foreign exchange differences	(1,370)
COST AND BOOK VALUE AT 30 JUNE 2014	39,546
Exploration costs capitalised	174
Impairment of charge	(12,310)
Capitalised mining lease	2,466
Foreign exchange differences	3,562
COST AND BOOK VALUE AT 31 DECEMBER 2014	33,438
Exploration costs capitalised	288
Foreign exchange differences	(1,124)
COST AND BOOK VALUE AT 30 JUNE 2015	32,602

The above value of intangible assets represents the cash and non-cash consideration paid by the Group at the time of acquisition. Included in the capitalised costs for the period is depreciation of £77,000 (2014: £100,000).

Impairment

The Directors have considered the following factors when undertaking their impairment review of the intangible assets:

(a) Geology and lithology on each licence as outlined in the most recent CPRs (independent Competent Person's Reports)

(b) The expected useful lives of the licenses and the ability to retain the license interests at renewal

(c) Comparable information for large mining and exploration companies in the vicinity of each of the licences

(d) History of exploration success in the regions being explored

(e) Local infrastructure

(f) Climatic and logistical issues

(g) Geopolitical environment

After considering these factors, the Directors have not made any impairment for the period to 30 June 2015.

6. NON-CONTROLLING INTERESTS

	£000
AT 1 JANUARY 2014	3,219
Non-controlling interest in share of losses	–
Acquisition of non-controlling interests	(773)
Non-controlling interest in foreign exchange differences	224
AT 30 JUNE 2014	2,670
Non-controlling interest in share of losses	(1,382)
Acquisition of non-controlling interests	(882)
Issue of shares to non-controlling interest	2,466
Non-controlling interest in foreign exchange differences	(311)
AT 31 DECEMBER 2014	2,561
Non-controlling interest in share of losses	(195)
Non-controlling interest in foreign exchange differences	85
AT 30 JUNE 2015	2,450

7. LOANS

During the period the Company entered into a £500,000 unsecured debt facility from an investment company which matures on 30 September 2015 and carries an interest rate of 1.25% per month. In addition 3,571,428 detachable call warrants were issued with a strike price of 7 pence per share.

8. SHARE CAPITAL

	Number	£000
Authorised:		
Ordinary shares of £0.01 each	Unlimited	Unlimited
Allotted, issued and fully paid ordinary shares of £0.01 each:		
AT 1 JANUARY 2014	288,595,917	2,886
Issued in the period	42,471,510	425
AT 30 JUNE 2014	331,067,427	3,311
Issued in the period	7,457,227	74
Purchased by the company and cancelled	(63,000,000)	(630)
AT 31 DECEMBER 2014	275,524,654	2,755
issued in the period	2,363,637	24
AT 30 JUNE 2015	277,888,291	2,779

Fully paid ordinary shares carry one vote per share and carry rights to dividends.

On 19 March 2015 the Company issued 2,363,637 new Ordinary Shares in Company at a price of 5.5 pence per share raising gross cash proceeds of £130,000.

9. SHARE PREMIUM ACCOUNT

	£000
AT 1 JANUARY 2014	47,168
Premium on issue of shares	925
Expenses on issue of shares	–
AT 30 JUNE 2014	48,093
Premium on issue of shares	238
Expenses on issue of shares	(65)
AT 31 DECEMBER 2014	48,266
Premium on issue of shares	107
Expenses on issue of shares	(3)
AT 30 JUNE 2015	48,370

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DIRECTORS AND OFFICERS

DIRECTORS

Philip Falzon Saint Manduca	*(Executive Chairman)*
Martin Doyle	*(Non-Executive Director)*
Stephen Grimmer	*(Managing Director)*
Simon Retter	*(Finance Director)*

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William Place Secretaries Limited

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