



Canada's diamond

Diamonds are forever but for investors the thrill is gone, except for those seeking undervalued diamond stocks. In the mid 1990s, the discovery of diamonds in Canada's north created a wave of excitement as prospectors, exploration companies and investors all jumped on the band wagon. Early success by Chuck Fipke's Diamet and Grenville Thomas' Aber Diamonds set the bar very high for investors' expectations.

Unfortunately, after that initial wave of excitement and billions of dollars spent searching for diamonds both in Canada and around the world, there is little to show for all that money and effort. There has not been a major new diamond discovery for well over a decade and speculative investors have decided to look elsewhere for blue sky opportunities. Research coverage of the sector has also dropped drastically, so unless you are prepared to do a lot of your own homework, getting up-to-date research on Canadian diamond explorers is difficult.

This is fertile ground for value investors who are looking for investments that the majority of the market is overlooking. There is money to be made in this sector

if you know who's who, what's what and when to get in and out.

There is also a hint that an important new discovery may have been made, which could ignite investor interest in the diamond sector once again. More on that later.

In the meantime, where should investors' look in this neglected sector? There are two parts to the sector, exploration plays and production plays. Since the production side in Canada consists of three majors and one pure diamond play, there is really only one producer that will give you pure exposure to diamonds and that is Harry Winston (formerly Aber Diamond).

The original Canadian discovery at Lac de Gras was made by Diamet and became

the Ekati Mine. It was swallowed up by BHP and now represents a line item on their massive income statement. The global diamond giant De Beers has two producing mines – the Victor pipe in Ontario and the Snap Lake deposit in the NWT. De Beers is now a private company so investors will have no chance of participating in diamond production there either. (However, rumour has it that De Beers is preparing to take itself public once again).

That leaves the remaining Diavik Mine which was discovered by Aber Diamonds in the mid 1990s. Rio Tinto owns 60%, Harry Winston 25% and Kinross Gold 15%. Kinross bought their share in March of 2009 when Harry Winston needed cash.

top five diamond plays

by Prentice Lee



Aber Diamonds morphed into a vertically integrated diamond company when it bought the prestigious jewellery retailer, Harry Winston.

So after almost two decades after the initial discovery in 1991, we have four diamond mines in Canada and none under construction. Given this glacial pace of discovery and development, it is not surprising that investors have moved on. So why should investors have any interest in the sector at all?

The answer to that comes from a combination of past failure to find new production and future growth in demand coming from Asia. Diamonds are a symbolic product. They have some uses as industrial products, for which they are irreplaceable, but the high value section of diamond production comes from the gemstones. Those expensive, glittery baubles have a highly emotional value because they are expensive. Diamonds symbolize intangibles like love, success and achievement. Historically, as the wealth of the world has increased, the demand for diamonds has taken up a proportionate share of that wealth.

We are now seeing the emergence of two major new markets for diamonds in China

and India. As the wealth of those nations increase, their demand for diamonds will increase. While that takes place over the next decade, we can be sure of one thing – diamond production will remain flat or decline. We know this because while diamonds are forever, diamond deposits are not. Old deposits will be depleted and new production will have trouble just replacing the decline caused by the shutting of played-out mines. We have seen no major new discoveries for more than a decade, which means there will be no major, new sources of production over the next decade. It takes seven to 10 years to go from discovery to production. This will set the stage for a healthy supply/demand ratio and firmer diamond prices going forward.

Given that backdrop and the lack of interest by investors in the diamond sector, valuations are attractive for those explorers who have found something worthwhile. While investors have been studiously ignoring diamond exploration companies, exploration has continued. Discoveries have been made (nothing major, but potentially significant discoveries). But things may be about to heat up once again in the Canadian diamond sector because of an

TOP: Maiko Sell, Project Geophysicist, prospecting at the Peregrine Diamonds Chidliak Diamond project on Baffin Island. Photo courtesy Peregrine Diamonds Ltd.

LEFT: Left to right, Brooke Clements, President, Hugo Grenon, Project Manager, and Greg Shenton, CFO, at the Peregrine Diamonds Chidliak Diamond Project on Baffin Island, Nunavut. Photo courtesy Peregrine Diamonds Ltd.

early-stage discovery on Baffin Island by Peregrine Diamond.

THE TOP 5 DIAMOND PLAYS IN CANADA

The numbers of diamond explorers has dwindled over the last decade, but there are still 20 or so companies that are exploring prospects of interest. There are a handful of companies that have found what may be commercial deposits. Here are the top five:

Harry Winston Diamond Corp.
[HW-TSX] \$10.46, Market Cap
\$827 million

Parlaying the richest, hard rock diamond deposit in the world into a vertically integrated diamond miner and retailer, the

Diamcor Mining acquiring De Beers alluvial diamond project

Diamcor Mining Inc. [DMI-TSXV], a proven supplier of rough diamonds to the world market, has a history of diamond mining production in the Kimberley region of South Africa. The company's acquisition of the De Beer's Krone-Endora Project is now in final closing. Krone-Endora is adjacent to the DeBeers flagship Venetia Mine, the third largest diamond mine in the world, producing about 50% of South Africa's diamonds. Venetia's peak production was 9 million carats in 2007 (approx. 750,000 carats/month) with a large percentage being reported as gem quality.

The deposits of Krone-Endora are directly related to Venetia, with the NI 43-101 report estimating about 1,000 metres of the tops of the Venetia kimberlite clusters has shifted from the higher Venetia grounds, resulting in a rare eluvial deposit. The near-surface nature of the deposit will allow Diamcor to employ a low-cost, strip-mining operation.

With Venetia as the source of the Krone-Endora deposit, diamond characteristics are expected to mirror those of Venetia in size, frequency and quality. Near-term trial mining exercises and drilling are slated to start soon, and are aimed at generating revenue and further defining the full potential of the project for an updated NI 43-101 report. Diamcor is targeting initial production of about 10,000 carats/month within 12-18 months and 30-35,000 carats per month within 24-36 months. ■

former Aber Diamond has become Harry Winston, the premier diamond player in Canada. Their Diavik Diamond Mine has been very profitable and a global shortage of diamonds will make their production all the more valuable. However, it is a depleting resource and HW may need to bolster its reserves somewhere along the way and the following four companies represent four potential targets.

Peregrine Diamonds Ltd. [PGD-TSX] \$2.16, Market cap \$179 million

A potential Cinderella story is unfolding with Peregrine Diamonds. In August 2008, Vancouver-based junior Peregrine Diamonds announced a discovery called Chidliak on Baffin Island, Nunavut. It kind of slipped by an uninterested market; however, BHP took notice and agreed to earn in 51% by spending \$22.5 million and by the end of the 2010 exploration season will have spent that amount of money. What investors need to look at are the results from their CH6 pipe which are completely off the scale in terms of anything else ever reported on early drill results in Canada. Three drill cores yielded 569 kilograms of kimberlite grading an outstanding 8 carats per tonne. In addition, in a little over two months of exploration in the summer of 2009, 16 kimberlites were discovered, 15 of which are diamondiferous. These are the best early results for a diamond exploration company in 15 years and they point to a potentially significant discovery.

In addition, Peregrine owns 71.4% of the DO27 pipe in the Lac de Gras region which hosts an estimated \$1 billion diamond deposit. At this point in time, the pipe is considered sub-economic, but given its location, approximately 40 kilometres from the Diavik Diamond Mine, the economics of this deposit may change through a combination of higher diamond prices and depleting resources at Diavik. With Eric Friedland and Brooke Clements at the helm and BHP funding exploration to the tune of \$13.5 million this year, the company has solid management to advance this project

Mountain Province Diamonds Inc. [MPV-TSX] \$2.13, Market Cap \$143 million

Mountain Province Diamonds is the Sleeping Beauty of the Canadian diamond world. The role of the wicked queen has been played by the operator and majority owner De Beers which has kept this project from advancing for more than a decade. The deposit, located in the Northwest Territories, is called Gahcho Kué. The initial discovery was made in the mid 1990s and diamond giant De Beers earned in a majority

by finding a cluster of kimberlites and spending a fair amount of money along the way. Since then, De Beers has kept MPV shareholders waiting as the South African diamond legend avoided advancing the project.

Gahcho Kué is one of the largest new diamond projects under development globally. The project consists of a cluster of kimberlites, three of which have an indicated resource of approximately 30.2 million tonnes grading at 1.67 carats per tonne (approximately 50.5 million carats) and an inferred resource of approximately 6 million tonnes grading at 1.73 carats per tonne (approximately 10.3 million carats).

Currently a definitive feasibility project is under way, due for completion in mid 2010. The magic number is 15% – that's the internal rate of return (IRR) De Beers has been looking for. If, according to the independent feasibility study, that hurdle can be jumped, a decision to build a mine will be made within 90 days. The results of this study will be published in August 2010, according to Patrick Evans, head of MPV. If it is positive, there is a lot of latent value in this long-slumbering beauty.

Shore Gold Inc. [SGF-TSX] \$1.00, Market Cap \$229 million

Since 1995, Shore Gold has been exploring, drilling and bulk sampling the very large kimberlite deposits in Saskatchewan, just 60 kilometres east of the city of Prince Albert. The company has discovered one of the most extensive kimberlite fields in the world.

The good news is that the deposit is huge, the diamonds are high quality and infrastructure is already in place. The bad news is that the grade of the deposit, at 13 carats per hundred tonnes, is low and contained under 90 metres of overburden. To put that into perspective, Harry Winston's Diavik pipe grades around 400 carats per hundred tonnes, more than 30x richer in grade. Shore Gold has a unique deposit since it contains the un-eroded magmatic flow of kimberlite – kind of like a giant muffin-top.

Most kimberlite pipes are the remaining roots of such a deposit, with the original surface flow having long ago been scraped off by glacial activity. This deposit still includes the original material that spilled out of the magmatic eruption many millions of years ago. It will take a combination of higher diamond prices and low operating costs to get this project off the ground, but given the outlook, we just might see that happen.

Stornoway Diamond Corp. [SWY-TSX] \$0.65, Market Cap \$193.25

Stornoway's main asset is the Renard cluster of kimberlites in the Otish Mountain region of Québec. After a highly dilutive takeover of Ashton Mining in 2006, Stornoway acquired a 50% share

of this asset but in doing so, have seen their fully-diluted shares outstanding balloon to more than 300 million. With that many shares outstanding, the share price has been unable to generate any traction since the takeover.

Recently, Stornoway released a revised 43-101 report which tripled the estimated resource with an indicated and inferred resource of 36.3 million carats grading US \$117 per carat. Stornoway has begun the permitting process which should take approximately two years to complete. Québec may be on its way to having its first diamond mine. ■

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