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June, 2018

MERLIN DIAMONDS LTD (MED)

Analyst | Peter Bird

QUICK READ

Merlin Diamonds (ASX:“MED”) (“Merlin” or “The Company”) is an ASX-listed diamond company on its way to becoming a dominant gem-quality diamond producer in Australia. Merlin is only one of two operating diamonds mines in the country and is located in Australia’s Northern Territory, 100km south of Borroloola. The Company boasts an impressive resource in both size and grade, surpassed in size only by Rio Tinto’s Argyle Diamond mine. Rio coincidentally was the initial developer and producer of the Merlin mine. With the Argyle Diamond mine scheduled for a potential closure in 2021, Merlin could soon potentially be Australia’s premium diamond producer and the only Australian producer. In past years, the Merlin mine has been credited with Australia’s largest diamond find (104cts) along with a large inventory of sizable diamonds, proving Merlin to be a world-class deposit. The Company also holds extensive exploration ground in and around the Merlin Diamond mine, the North Kimberley and Arnhem Land, and has identified numerous exploration targets for additional sources of diamonds. Merlin has recently streamlined its path to market for its gem-quality stones with the opening of a sales office in Antwerp, which offers a direct path from mine to wholesaler of rough diamonds. The Company is led by mining magnate, Joseph Gutnick (“Diamond Joe”) as well as a highly experienced board and management team.

KEY POINTS

WORLD CLASS DEPOSIT: Merlin is famous for its past production of large, high-quality diamonds. The mine recovered the largest diamond ever discovered in Australia at 104ct as well as a 43ct, 32ct and 28ct diamond. The March quarter, 2018 saw the Company recovering a 18.75ct flawless cognac diamond. There are very few mines in the world that have the proportion of high-quality, large diamonds like Merlin. Historically, the mine boasts an impressive production of 65% - 75% gem-quality compared to Rio Tinto’s Argyle diamond mine gem quality of just 5% and with the global average being approx. 20% gem-quality.

RESOURCE: Merlin is placed in a well-known and understood set of kimberlite deposits. The Company has identified a total of 13 kimberlite pipes, two of which, Sacamore and Palomides (PalSac), have a predicted mine life of up to 12 years. In addition to the highly prized crystal-clear diamonds, Merlin is also proving-up the possibility of the rare and highly prized blue, pink and green coloured diamonds. This indicates a high-value project with plenty of diversity in colouration type.

From the various Kimberlitic volcanic pipes under Merlin’s tenure, the Company is **estimated to have an Inferred Mineral Resource of 15.93Mt and an Indicated Resource of 3.1Mt. In total, Merlin’s diamond project in the Northern Territory is estimated to contain 19.02Mt at 24cpt for 4.31Mcts.**

EXCELLENT ECONOMICS: Empire Capital Partners (“ECP” or “Empire”) has concluded that the Merlin Project has very attractive project economics. ECP estimates annual EBITDA of **AUD\$61.4**, based around the following parameters; **USD\$300/ct**, at an average pipe grade of **24 cpht** and a processing throughput of **702ktpa for an estimated 134,808cts/annum (11,234 cts/month)** over a 10-year forecast. These financial forecasts do not account for +20mm - 40mm diamonds, which will be recovered by the Tomra XRT machine and as such, Empire believes the Project holds up very well on key assumption sensitivity analysis (see Figure 21).

MULTIPLE DIAMOND PRODUCTION CENTRES: Merlin has been preparing to commence full-scale mining operations at its high-grade diamond pits Gawain and Excalibur, with mining contractor Rusca Bros, ramping up mining operations over the course of Q3’18. The pits have recently been dewatered, along with the Ector pit and the Company is awaiting the arrival of a new scrubber/trommel and DMS module to commence full-scale operations. Merlin believes Gawain and Excalibur, as well as PalSac, to be highly profitable operations for the Company.

RECOMMENDATION: Merlin presents a speculative buy to investors. With a market cap of just \$25.8M, early investors could be buying into an overlooked resource that has significant potential to return and potentially surpass its previous past performance. The recent commencement of full-scale mining activities for Merlin will be a major catalyst for share price increase, along with a steady news flow concerning diamond production and major finds.

MED.asx

Share price	\$0.008*
52 Week High/Low	\$0.012/\$0.004
30-day Avg. Volume	7,896,030
Recommendation	Speculative Buy
Price Target – 12 months	\$0.067

Brief Company Description:

Merlin Diamonds Ltd engages in the exploration and development of diamond projects in Australia. It principally owns the Merlin Project, which is comprised of the Merlin diamond mine operations and the surrounding exploration tenements (2,062 km²) located in the Northern Territory. The company is headquartered in Melbourne, Australia.

Board of Directors:

Mr. Joseph Gutnick (Exec. Chairman, Dir.)
Mr. Mordechai Gutnick (CEO)
Mr. Henry Herzog (Non-Exec Director)
Mr. David Tyrwhitt (Non-Exec Director)
Mr. Peter Lee (CFO & Company Secretary)

Top Shareholders:

Chabad Properties Pty Ltd	14.15%
Regal Fund LP	8.08%
Mr. Vince Zangari	3.14%
Mr. Robert Jesse Hunt	1.30%
IFM Pty Ltd	1.25%

Company Address:

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Melbourne, VIC 3006 AUS

Company Contact:

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Facsimile: + 61 (03) 8532 2805
Email: info@merlindiamonds.com

Issued Capital	3,110M
-fully diluted	4,051M
Market Cap	25.80M*
-fully diluted	30.99M
Cash (30 Dec’17)	A\$ 2.0M
Debt (30 Dec’17)	A\$0.0M

MED 1 Year Share Price Chart



*Price as at 20/07/18



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INVESTMENT THESIS – MERLIN DIAMONDS

AUSTRALIA'S PREMIER DIAMOND PRODUCER

With Rio's Argyle Diamond mine scheduled for a potential closure in 2021, Merlin could soon potentially become the premier producer of diamonds in Australia. Merlin has proven to possess not only large high-quality white diamonds, but also the possibility of highly prized and extremely exclusive blue, green and pink colored diamonds. Merlin discovered a 1.448ct blue/green diamond from its Merlin mine, a 1.42ct green diamond and 32 pink diamonds during H1'18, demonstrating the potential for valuable colored diamonds at its mine. Recently, an 8.01ct blue diamond sold for \$17.1M at an auction at Sotheby's, indicating the worth of such diamonds. On average over the past decade, the price of pink diamonds has increased year on year by 10%. This increase is being pushed by a growing deficit between supply and demand; every year the demand for pink diamonds increases while the supply is reducing.

ENHANCED OPERATIONS

The Tomra XRT is Merlin's latest, cutting-edge mine processing technology, used only by a handful of tier-1 diamond producers. The technology makes it possible for the Company to obtain a high purity level in sorting materials, irrespective of size, moisture or surface pollution level. The Company believes that by using this new sorting technology, it is expected that larger diamonds will be recovered (100ct+) than previously possible, as well as the recovery of low luminescence diamonds. Through the use of this machine, Merlin is confident that it will be proven as a tier-1 diamond operation with a world-class deposit.

Figure 1: Merlin's fully functioning Tomra XRT machine



Source Company Data

Along with the commissioning and optimization of the XRT, Merlin has also progressed to enhance other aspects of its diamond processing circuit. A high-performance screening and sizing trommel/scrubber has been ordered and is scheduled to arrive from China during Q3. This will result in a streamlining mineral recovery process and increase the head feed rate from the current 50tph to 100tph. A dense medium separation (DMS) module is set to arrive from South Africa in Nov/Dec'18 and will boost the +2mm -18mm production rate from 15tph to 40tph, increasing the total throughput of the recovery and processing circuit to upward of 150tph.

"DIAMOND JOE"

Joseph Gutnick is a leading mining industry entrepreneur with a proven track record of wealth creation for shareholders. In 1989, Mr. Gutnick was responsible for overseeing the discovery of the 11 million ounce gold deposit at Plutonic Mine. Furthermore, his business growth extends to the discovery, development and operation of the world class Jundee and Bronzewing gold mines in Australia, which produced over 9 million ounces and is still rising. Mr. Gutnick is a Fellow of the Australian Institute Of Mining And Metallurgy and a former Director of the World Gold Council. He was awarded the prestigious Diggers Award at the 1997 Diggers and Dealers Industry. His experience and dedication in the gold industry is legendary and is determined to make the Merlin Diamond mine his latest and greatest mining success.





INVESTMENT THESIS CONT.

2018, THE MERLIN DREAM REBORN

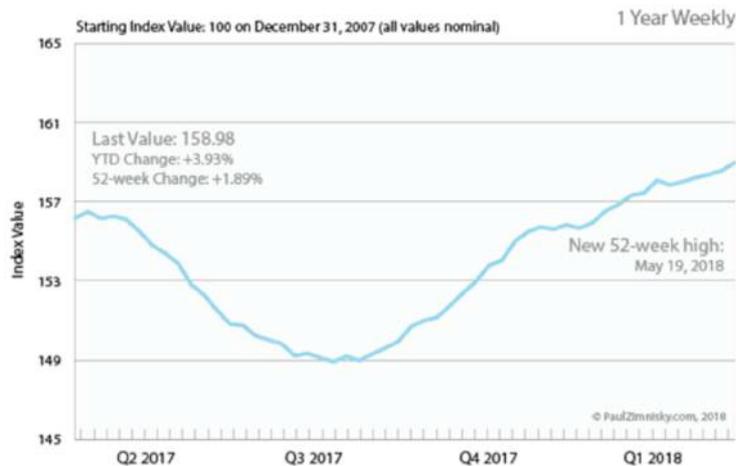
During Q3'18, Merlin will have successfully transitioned from a mere 'pipe dream' to a fully producing diamond mine. Mining contractors, Rusca Bros. are ramping up full-scale mining operations over the course of Q3'18 at the Gawain and Excalibur pits, targeting an estimated annual production of 702ktpa for 134,808cts/annum.

Over the course of the past 6 months, Merlin has been actively recovering diamonds from ore stockpiled on the ROM pad. Over 1,000 diamonds have been recovered, which included a 7.313ct fancy yellow diamond, an 18ct cognac diamond, along with multiple blue, green and pink diamonds. The Company aims to announce diamond production and sales on a quarterly basis, from Q3 2018.

POSITIVE OUTLOOK FOR DIAMOND MARKET

Diamond prices are expected to rise throughout 2018 on the back of a decrease in global diamond production, with producer inventories at multi-year lows. May 19th '18 saw rough diamonds reach a new 52-week high (USD\$158.98/ct) (Figure 2). A 10% cumulative increase in diamond price is forecast over the course of 2018 through to 2021, considering the backdrop of a strengthening global economy, no major global economic disturbances, signs of a stronger Mainland Chinese market, and the Diamond Producers Association increased budget fueling the return of generic diamond marketing.

Figure 2: Zimnisky Global Rough Diamond Price Index



Source Government data, Paul Zimnisky analysis and forecasts

RECENT SALES

In the most recent sale, Merlin sold a 13.27ct high quality white diamond in Antwerp late August 2017, achieving a price of AUD\$14,492 per carat for total revenue of AUD\$192,613. The Company has also streamlined its diamond selling process with the opening of a sales office in Antwerp, where more than 80% of the world's diamonds are sold. Moving forward, Merlin plans to sell its polished diamonds from previous production.





SWOT ANALYSIS

STRENGTHS

- Experienced management team
- Historical track record of diamond production
- Rare colored and large, high quality white diamonds
- Significant exploration potential around the Merlin mine area and in the North Kimberley
- Existing infrastructure and processing capacity for over 100kcts/yr
- Tomra XRT diamond sorting technology
- "Diamond Joe"

OPPORTUNITIES

- Imminent closure of Rio's Argyle Diamond mine will render Merlin as Australia's prominent diamond producer
- Potential to expand known resource through exploration
- Increasing demand for the colored diamond variety as supply decreases
- Polished and rough diamond market stabilized after year-on-year decreases since 2014
- New scrubber able to process wet material

THREATS

- Increasing presence of lab grown diamonds in the market

WEAKNESSES

- Operations are in a remote, hard to access area – wet season flooding makes road access impossible
- Grade fluctuations



THE MERLIN STORY

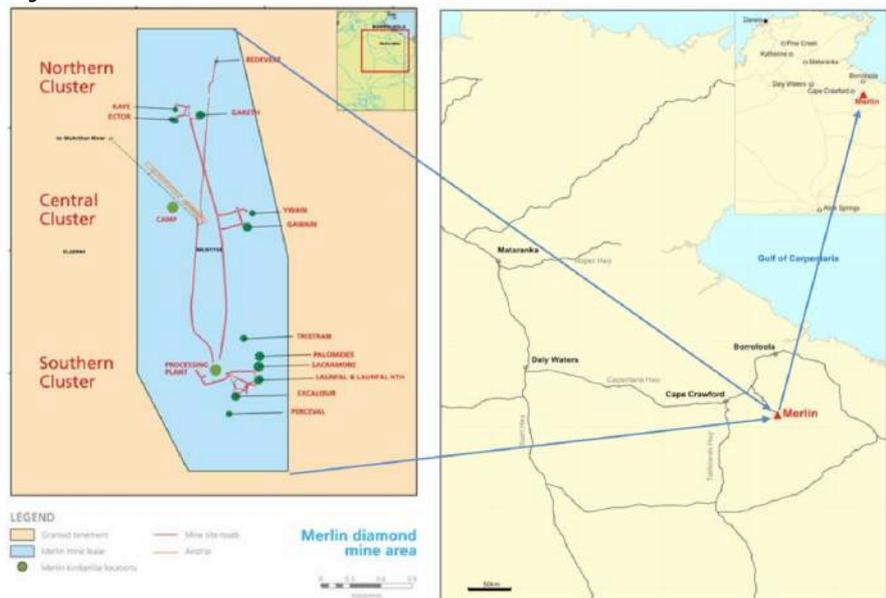
THE PROJECT OVERVIEW

The Merlin mine story dates back to the early 1990's when the first discovery of diamonds was by Ashton Mining Ltd after systematic exploration between 1991 and 1994. After periods of trial mining and feasibility studies, Ashton Mining Ltd was taken over by Rio Tinto Pty Ltd. Merlin was too small to fit into the asset portfolio of Rio Tinto and was later sold off in 2004.

Over a 5-year period, between 1998 and 2003, 9 of Merlin's 13 kimberlite pipes were subject to open-pit mining over, **producing approx. 507,000cts of diamonds, valued at AUD\$132/ct.** During this short operational life, the Merlin Diamond Project was renowned for the production of top quality white diamonds and large specials, the largest being 104.73ct. Merlin Diamonds Pty Ltd, formerly North Australian Diamonds, acquired the project from the Rio Tinto Group. Since that time resource definition drilling and trial production increased the known JORC-compliant Resource of diamonds to be the second largest in Australia, surpassed only by the Argyle Diamond mine.

Under the leadership of Joseph Gutnick, feasibility studies examining options to enable near term production at Merlin were commissioned. As a result of these studies, the company applied for and was granted a MMP (mining management plan), which enabled it to recommence diamond production in 2013. A new MMP has since been approved for the Company. **In 2012, a parcel sourced from Merlin was sold on international markets generating proceeds of AUD\$2.275M.** Between 2013 and 2016, Merlin conducted various trial drilling methods and feasibility studies to ascertain the most productive and cost-effective method to mine the kimberlite deposits.

Figure 3: Merlin Mine Location & Tenements



Source Merlin Diamonds PFS

LOCATION

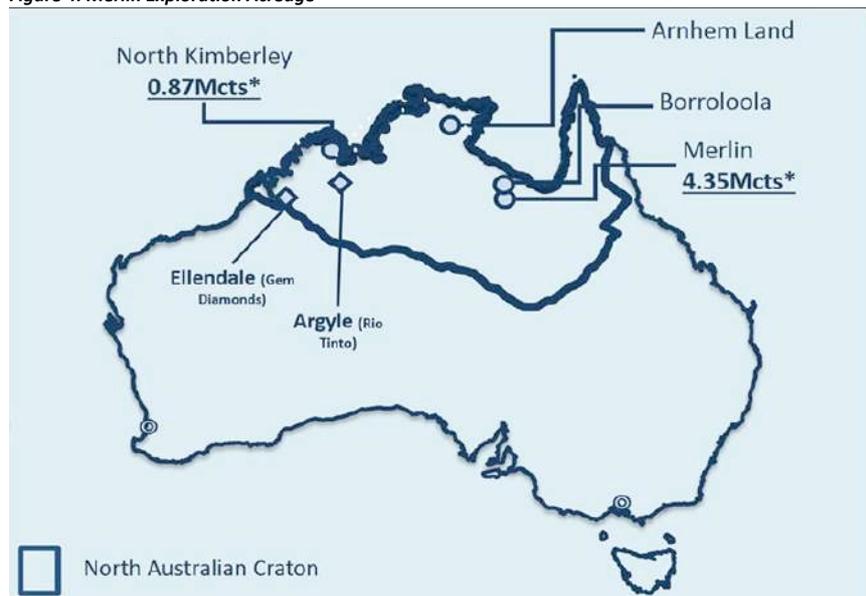
The Merlin Diamond Project is located some 100km south of the settlement of Borroloola, located in the Batten Trough of the southern McArthur Basin in NT. The closest major city is Darwin, located approx. 725km from the Merlin mine.

MERLIN DIAMOND PROJECT

TENEMENTS

Merlin has some top end tenement holdings with an excellent reputation in the market in the resource-rich NT of Australia, including Arnhem Land, and WA in the North Kimberley – about 22,000km² in total. As envisioned in Figure 4, this land covers extensive exploration ground in and around the Merlin Diamond mine. Although not a current focus for Merlin, there is a clear opportunity to further extend its diamond resources. There are four major areas that make up the Company's tenement portfolio; Merlin Mine and its immediate vicinity (NT), Merlin Orbit – broader area around Merlin (NT), Arnhem Land (NT) and North Kimberley (WA).

Figure 4: Merlin Exploration Acreage



Source Company Reports

However, it is Merlin's holding in the Borroloola Project Area, where the Merlin Diamond mine sits, which is most prospective and has already proven to be lucrative.

Merlin Mine and Immediate Vicinity (NT)

Although the immediate area surrounding the Merlin mine has remained relatively unexplored, 74 targets have been identified as requiring further investigation with seven of the targets ready for immediate drilling.

Merlin Orbit (NT)

Merlin is in acquisition of a portfolio of tenements in the region surrounding the Merlin diamond mine that are highly prospective for the discovery of additional kimberlites or alluvial diamond deposits.

North Kimberley (WA)

Merlin holds three mining licenses within the North Kimberley region of WA. These leases include the Ashmore and Seppelt kimberlites.

Arnhem Land (NT)

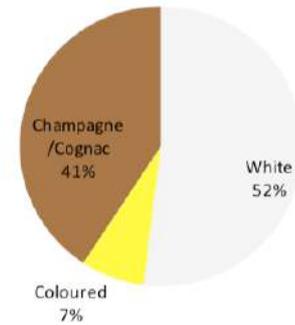
The Company holds one granted exploration license in the Arnhem Land along with a further 47 exploration licenses which are currently in application stage, managed by Merlin Diamonds or under joint venture agreements with other parties.

RESOURCE

JORC ORE RESOURCES AND RESERVES

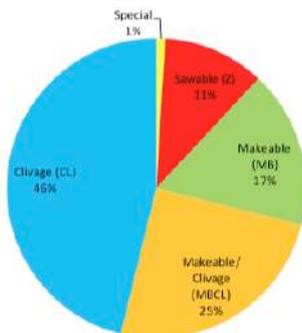
The total Merlin diamond Mineral Resource and Ore Reserve is the second largest diamond resource in Australia. The total Merlin JORC compliant indicated and inferred Ore Resource is estimated at **19.02Mt to contain 4.31Mcts with a probable ore reserve estimated at 4.0Mt for a contained 0.61Mcts**, at its flagship Merlin mine. As well as an enormous resource, the Company also possesses very **high average grades – 24cph**. The average gem-quality diamond production at diamond mines globally is 20%. Merlin has **65-75%** historically – eclipsing most rivals, especially Australia's largest diamond, Argyle, only boasts around 5% gem-quality. Merlin's remaining 25-35% are classified as near-gem or industrial quality.

Figure 6: Proportion of Merlin Diamond Types



Source Merlin Diamonds PFS

Figure 7: Merlin Diamond's Quality classification



Source Merlin Diamonds PFS

Figure 8: Merlin Probable Ore Reserve

	Probable Ore Reserve (Mt)	Grade (Cpht)	Carats (Mcts)
Excalibur	0.25	31	0.08
Palomides	0.39	17	0.07
Launfal	0.13	14	0.02
Gawain	0.27	32	0.08
Ywain	0.06	58	0.03
Gareth	0.08	19	0.02
Kaye	1.04	12	0.13
Ector	1.83	10	0.19
TOTAL	4.04	15	0.61

Source Merlin Diamonds PFS

Figure 5: Merlin JORC Ore Resources & Average Diamond Val./Pipe

	Indicated Mineral Resource (Mt ¹)	Inferred Mineral Resource (Mt ¹)	Total (Mt ¹)	Grade (cph ¹)	Carats (Mcts ¹)	USD\$ /Ct
Southern Cluster						
PalSac		6.59	6.59	30	1.96	344
Launfal	1.58	1.70	3.28	25	0.82	405
Excalibur	0.46	0.31	0.77	34	0.26	382
Tristram		0.74	0.74	6	0.04	
Central Cluster						
Gawain	0.53	0.61	1.14	39	0.45	424
Ywain	0.02	0.10	0.12	81	0.09	336
Northern Cluster						
Gareth	0.13	0.14	0.27	22	0.06	276
Kaye		2.14	2.14	12	0.26	376
Ector		3.47	3.47	7	0.26	299
Bedevere	0.37	0.14	0.50	21	0.11	
TOTAL	3.09	15.93	19.02	24	4.31	352

Source Merlin Diamonds PFS

1. Mt = million tonnes, cph = carats of diamonds per hundred tonnes, Mcts = millions of carats of diamonds.

The above Mineral Resource and Ore Reserves estimates are effective from 30 September 2014 and have been reported in accordance with the 2012 JORC Code and are based on documentation prepared by a Competent Person as defined by the JORC Code.

The Global Mineral Resource estimate detailed above forms the basis of the Recoverable Mineral Resource grades. The diamond grade frequency distribution for each pipe was derived from production data, previous data from Rio (former operator) and bulk sampling information. This constitutes substantial grade data for the pipes and accurately defines the majority of the grade frequency distribution.

PIPE CHARACTERISTICS

Within the Merlin mine are three clusters – a northern, central and southern cluster. Within these clusters are rough diamonds - white and coloured, renowned for their size and quality. A feasibility study undertaken by the Company reached the following conclusions concerning each of the clusters:

- Excalibur, Palomides, Sacamore and Luanfal (Central and Southern clusters) have similar colour distributions;
- Gareth, Ector and Kaye (Northern cluster) is dominated by large cognac and champagne (brown) diamonds;
- Ywain and Gawain (Central cluster) possess the highest grades, followed by the Southern, then Northern clusters.
- Kaye and Ector (Northern clusters) have the lowest grades but tend to have the largest diamonds;
- Merlin has a high percentage – approx. 52% of super white, gem quality stones.



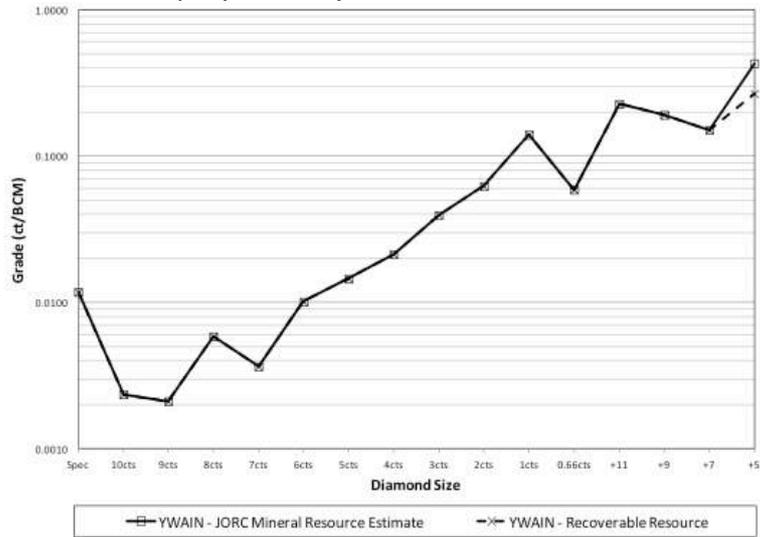
RESOURCE

GRADE FREQUENCY DISTRIBUTION

The grade frequency distributions used for the Global Mineral Resource estimate have been used for the Recoverable Mineral Resource for all Merlin’s kimberlites, except for Ywain and Gawain. The grade of the +5DTC, +3DTC and -3DTC fractions for the Ywain and Gawain grade frequency distributions used for the Global Mineral Resource estimate have been reduced to the historically recovered grades.

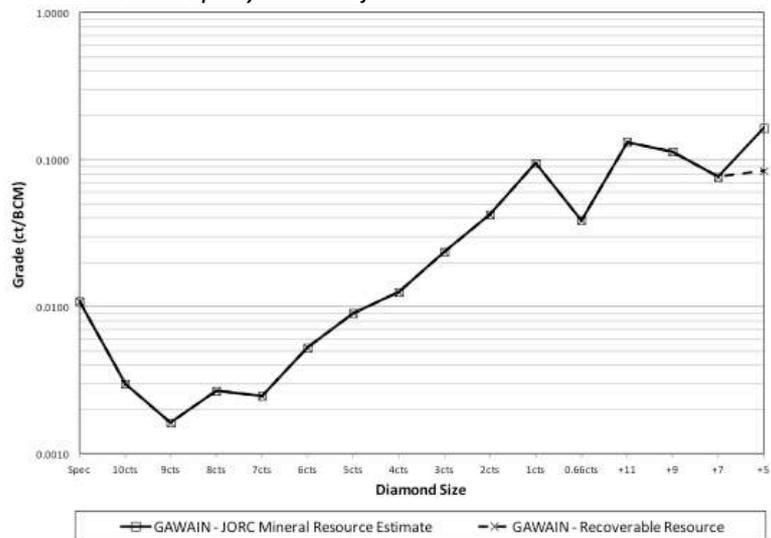
Figure 9 and Figure 10 show Ywain and Gawain Global Mineral Resource estimate grade frequency distributions with higher grades in the smaller fractions derived from bulk sampling, grade samples and drill core assay data. The smaller fractions of the Global Mineral Resource estimate grade frequency distribution have been reduced to the historically recovered grades to form the Recoverable Mineral Resource. The Recoverable Mineral Resource grade frequency distributions for Ywain and Gawain are reliable estimates of the grades from a commercially operated diamond recovery plant. Figure 11 shows the grade frequency distributions for all pipes.

Figure 9: Ywain Grade Frequency distribution for Global Mineral and Recoverable Mineral Resource Estimates



Source Merlin Diamonds PFS

Figure 10: Gawain Grade Frequency distribution for Global Mineral and Recoverable Mineral Resource Estimates



Source Merlin Diamonds PFS

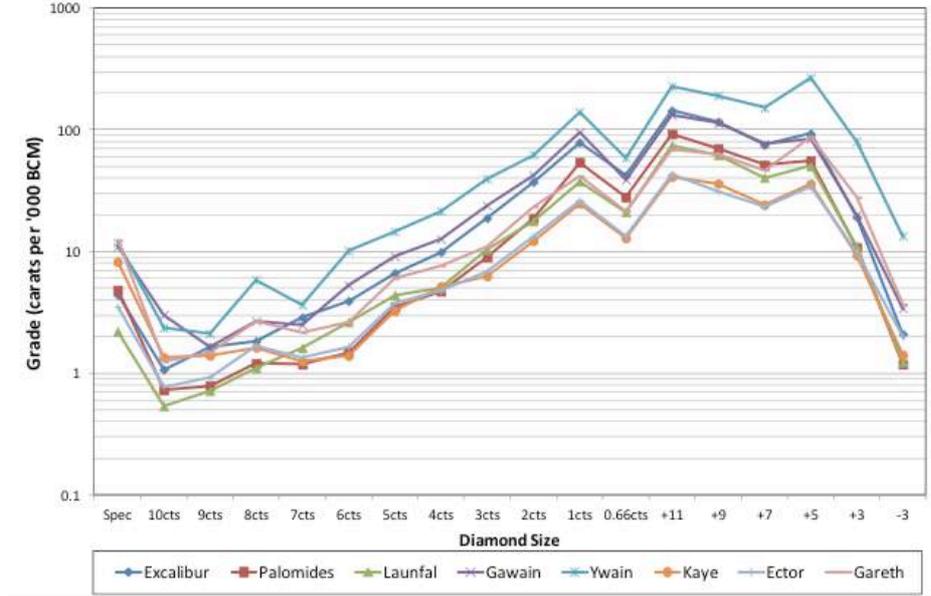




RESOURCE

GRADE FREQUENCY DISTRIBUTION CONT.

Figure 11: Grade Frequency Distributions for all Pipes



Source Merlin Diamonds PFS



GEOLOGY

The Merlin kimberlite cluster comprises 13 small discrete pipes and two venting sandstone breccia pipes that occur in a 10 × 5 km north-northeast-trending field. The high value of diamonds from the Merlin pipes is related to the significant recovery (30% by weight) of gem quality stones and relatively high (55%) proportion of white gems. Diamonds are found in all of the Merlin pipes with an unusually high proportion of gem-quality diamonds - 65-75% of production is gem-quality, and only 25-35% is classified as near gem or industrial grade. The 13 pipes on the Merlin project are Gareth, Sacramore, Launfal, Excalibur, Palomides, Kay, Ywain, Gawain, Tristram, Bedevere, Ector, Emu 1 and Emu 2.

The property’s diamond-bearing kimberlite pipes are believed to have intruded the sedimentary rocks of the southern McArthur Basin and northern Georgina Basin. Much of the diamond mineralisation is disseminated in volcanic rocks. The mineralisation occurs as Cratier-facies sequences comprising of country rock with minor juvenile material.

The largest Merlin pipes, Kay and Ector, are 125m in diameter (area ca 1.2ha) and all pipes tested by drilling have been shown to retain consistent widths to depths greater than 100m. Closely associated with the Merlin cluster are two small (20m diameter) breccia pipes within 250m of Perceval, the southernmost Merlin pipe. There are two larger pipes, Emu 1 (250m diameter) and Emu 2 (125m diameter), 3km north-northeast of the northern extent of the Merlin cluster. Two more breccia pipes (Abner Range Breccia Pipes, 80 and 40m diameter) occur 48 km west of the Emu pipes. The largest diamond in Australia (104ct and valued at AUD\$640,500) was recovered from the Gareth pipe.

Figure 13: Cross section of Gawain



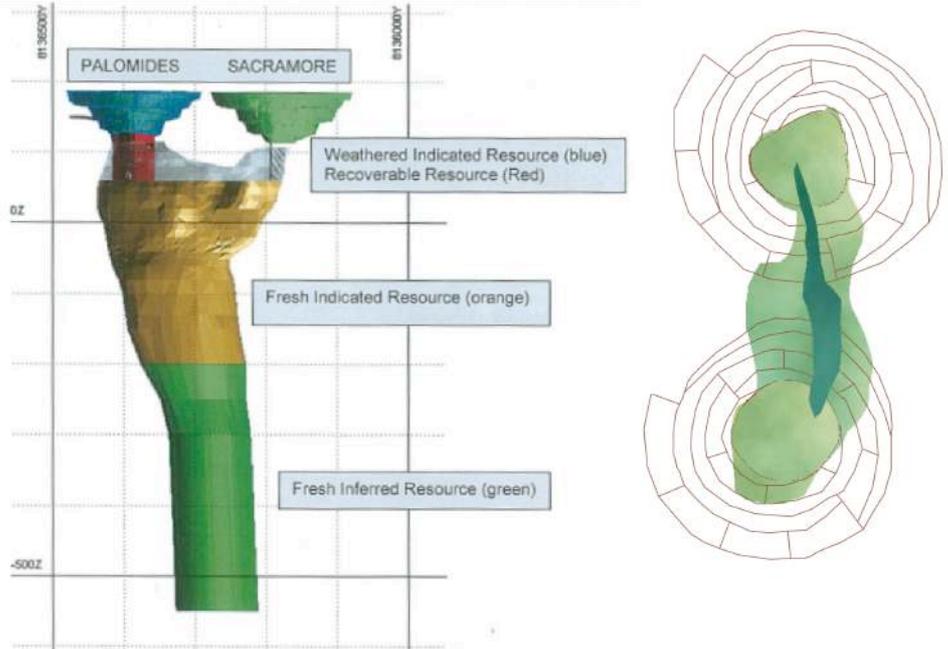
Source Company Reports

Figure 14: Cross section of Ywain



Source Company Reports

Figure 12: Cross section and bird eye depictions of the Sacramore and Palomides pits



Source Company Reports

Figure 12 depicts Merlin’s Sacramore and Palomides pipes, often abbreviated as “PalSac” due to their proximity to each other (>60m). Drilling has shown that they merge to form the same body at a depth of 80m. Merlin has estimated these two pipes to have a life of approx. 12 years with a grade of 30cpt, accounting for the bulk of MED’s JORC resource.

INFRASTRUCTURE

Merlin has all the necessary infrastructure required for a fully functioning mining operation. Previous mining operations by Ashton in 1998 and Rio in 2000 created most of the currently existing mining infrastructure. The original plant was dismantled in 2003 by Rio and replaced in 2005 by Striker Resources Ltd with a smaller scale processing plant. Merlin successfully recommissioned the plant in Oct'13.

The Merlin Mine is accessible via road and is around 1,000km from Darwin, along the Stuart Highway, with an East turnoff along the Carpentaria Highway. The final 60km is along a gravel road that, due to heavy wet season rains, becomes impassable during the wet season months - November-February. Wet season pre-planning for fuel and other consumables is required during this period.

The site also includes a private airstrip for light aircraft, which has a Northwest to Southeast orientation and was purpose built for the previous mining operations. Merlin's previous use of light aircraft remains the principal mode of FIFO transport with the aircrafts capable of seating <10 persons. CareFlight has also certified the airstrip for day and night emergency evacuation. Alternative access is via The MacArthur River Mine airstrip, serviced daily by AirNorth charters from Darwin, approx. 60km road journey from Merlin's operations.

Merlin has already established a village with accommodation, electricity, and sewerage facilities, and currently has a team of about 15 people on the job. Figure 15 shows an annotated bird's-eye view of the site.

Figure 15: Merlin Mine Site Existing Infrastructure



Source Merlin Diamonds PFS

The accommodation village contains a total of:

- 30 ensuite rooms
- 24 single person quarters with associated ablution block/laundry
- An exploration office
- A mining office
- A contractor's office
- A wet mess and dining facility
- Stores and a workshop
- Security infrastructure

The Merlin Diamond Mine has sufficient water supply sourced from local water bores and has adequate waste water treatment facilities and waste disposal facilities. Power generation for the village and processing plant is from onsite diesel-powered generators and communications is via a satellite service provider.

OPERATIONAL OVERVIEW

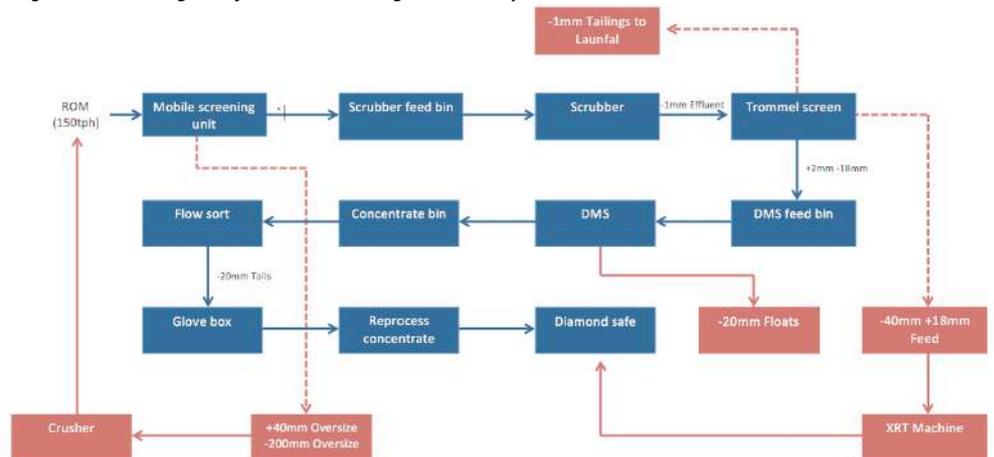
PROCESSING AND RECOVERY CIRCUIT

The processing design for the Merlin Diamond Project anticipates a throughput rate of 150tph utilising the new DMS module and scrubber as well as the Tomra XRT machine. Merlin estimates an annual processing capacity of 702Ktpa for a recovery of 134.8kct per year over the current LOM - 15 years. The current processing circuit is sectioned into three key stages, as listed below.

SCREENING: Onsite diggers will convey stockpiled ore on the ROM pad through Merlin's new mobile screening unit in order to screen out oversize material. Oversize +40mm - 200mm material will not pass through the processing plant and instead stockpiled on the ROM pad. Merlin's new crushing unit will be used to reduce the material to sub-40mm to allow the processing of the oversized material.

SCRUBBER: Screened material will be transferred via the scrubber feed transfer conveyer into the scrubber feed bin then into the scrubber. The scrubber will discharge material on to Merlin's new high-performance screening and sizing trommel unit, which will separate material into three different size fractions; -1mm, +2mm - 18mm and +18mm - 40mm. The larger +18mm - 40mm material will be conveyed to the XRT machine for screening, -1mm will be transported to the tailings dam at Launfal and the +2mm - 18mm material will be conveyed to the DMS module.

Figure 16: Flow Diagram of Merlins Processing and Recovery Circuit



Source Company Data

DMS: The DMS module will be fed from material in the DMS feed bin at a head rate of 40tph. The DMS is reliant on the simple process of specific gravity to further sort the +2mm - 18mm material. The DMS module requires the use of powdered ferrosilicon which is suspended in water, to form a pulp that is close to the density of diamonds (3.52g/cm^3). Once the ideal density is reached, the diamond bearing material is added to the slurry and the separation process begins. Gravity causes the heavy material to sink to the bottom, while lighter material rises to the top. The process effectively separates diamonds from other material through the law of gravity. The mixture will swirl at low speed forcing the heavier material to the walls and bottom of the cyclone, to be filtered from the rest. From here, separated material is sent to the glove box for hand sorting.

XRT: The Tomra XRT utilises an electric X-ray tube and a highly sensitive cutting-edge X-ray camera to penetrate material and capture a density image at high speeds to separate high and low-density fractions. The XRT will process the larger +18mm - 40mm material separated from the wet sizing screen to find larger and low luminescence diamonds. The XRT is expected to process feed above 80tph. From here, separated material is sent to the XRT bin for hand sorting.



FINANCIALS

SUMMARY

Empire believes the Merlin Project to be economically feasible, based around the assumptions listed in Figure 17. Full-scale mining operations, at Excalibur, Gawain and Ywain, will be ramping up over the course of Q3'18 with Merlin having already commenced production on predominantly oversized ore previously stockpiled on the ROM pad. We estimate that the Merlin Diamond Mine has an estimated NPV of AUD\$193.4M with a diamond price of USD\$300/ct, an average grade of 24cpht and using a discount rate of 10%. Current project valuations are estimated using a long-term exchange rate of 1.22USD to the Dollar. Figure 18 demonstrates that project valuation is highly sensitive to diamond price, but less sensitive to discount rates. As such, any projected price increase for diamonds would have a very positive affect on overall NPV and cash flows.

Figure 17: Major Assumptions

ITEM	ASSUMPTION
FIRST PRODUCTION	Production commenced
PLANT CAPACITY	0.7Mtpa
CRUSH, SCRUB, SCREEN TPH	107tph
AVERAGE GRADE	24cpht
+4MM CARATS/MONTH	4,783ct
-4+2MM CARATS/MONTH	6,451ct
RECOVERY	95%
% UTILISATION (7200HRS/A)	75%
AVERAGE MINING COST	AUD8/t
AVERAGE PROCESSING COST	AUD11/t
OVERHEADS	AUD13.4/t
DAYS PER MONTH	30.4
AVERAGE DIAMOND PRICE	USD\$300/ct
EST. +4MM PRICE	USD\$669/ct
EST. -4+2MM PRICE	USD\$124/ct
EXCHANGE RATE (AUD/USD)	0.78
DISCOUNT RATE	7.5%, 10%, 12.5%
ROYALTY	1.75% (of revenues)
NATIVE TITLE	2% (of profit)
COST OF SALES	4% (of revenue)
COMPANY TAX RATE	30%
TAX LOSSES	+AUD100M (before tax paid)
AVERAGE ANNUAL PRODUCTION (EST.)	134.8kct
MINING DURATION	15 years
MINING METHOD	Free dig/drill & blast

Source Company Reports, Empire Estimates

Figure 18: DCF Valuation

*DCF Model offsets tax losses & factors in various listed levies

	DIAMOND PRICE (USD/CT)		
	250	300	350
7.5% - NPV	35.6	213.9	452.6
7.5% - \$SP	0.012	0.073	0.154
10.0% - NPV	31.8	193.4	407.8
10.0% - \$SP	0.010	0.067	0.274
12.5% - NPV	28.6	175.9	369.9
12.5% - \$SP	0.009	0.059	0.126
	15	24	35
	AVERAGE GRADE (CPHT)		

Source Company Reports, Empire Estimates



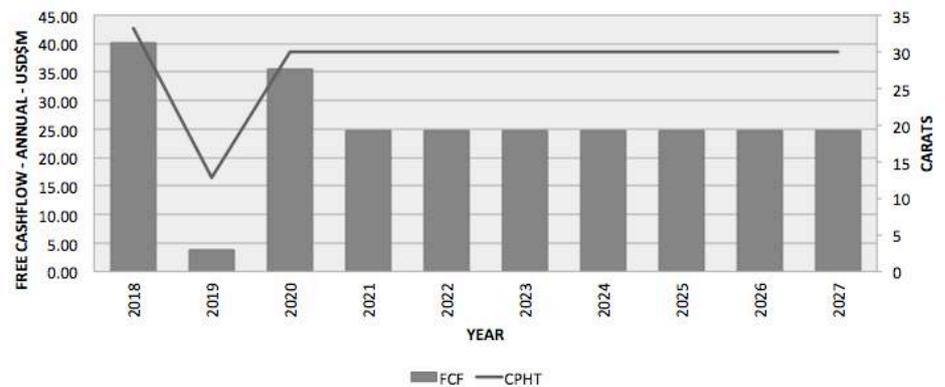


FINANCIALS

FREE CASHFLOW

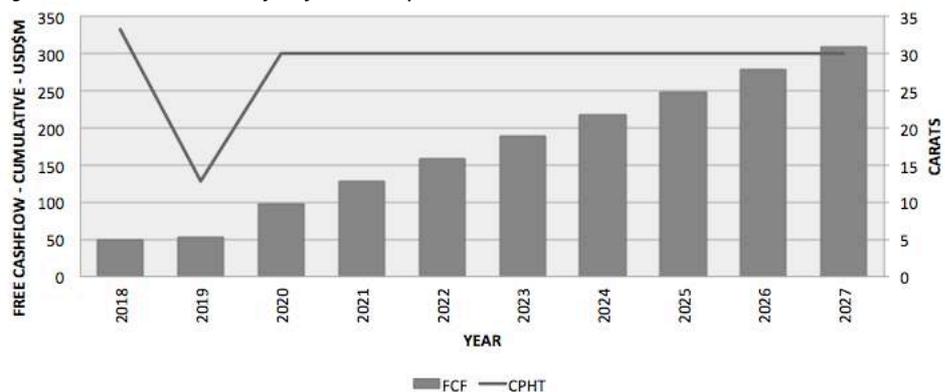
Based on the assumptions detailed in Figure 17, and various Merlin reporting data, Empire conducted a free cash flow analysis to ascertain the profitability of the Merlin operation. With high-grade diamond mining having commenced at the beginning of FY19, ECP estimates a free cash flow of AUD\$49.1M for the year. ECP anticipates a significant reduction in free cash flow – AUD\$4.59M - for FY19 due to the low-grade nature of the Ector Kimberlite – 7cpt. Once full-scale mining commences at Merlin’s high-grade Palomides and Sacramore pits at the beginning of FY20, the Company should see a significant improvement in cash flow – AUD\$43.4M. As of 2021, Merlin will reach its estimated tax offset threshold, after which a 30% tax rate will apply – decreasing the annual free cash flow to AUD\$30.26M and remaining stable for the remainder of the 10-year forecast period. Empire has factored in various other levies, which apply to the Company’s cash flow, namely, royalty payments, native titles and cost of sales. Figure 20 represents the cumulative free cash flow for the Merlin operation over the forecast period, with Empire estimating a cumulative free cash flow of AUD\$309.57M by the end of FY27, therefore deeming Merlin to be a highly profitable and feasible mining operation.

Figure 19: Annual Free Cashflow for Merlin Operations



Source Company Reports, Empire Estimates

Figure 20: Cumulative Free Cashflow for Merlin Operations



Source Company Reports, Empire Estimates

DIAMOND PRICING

To maintain a conservative position on the above financial forecasts, Empire have elected to use a diamond price of USD\$300/ct, this represents a USD\$52/ct discount as compared to the historical pricing data provided by the Company.





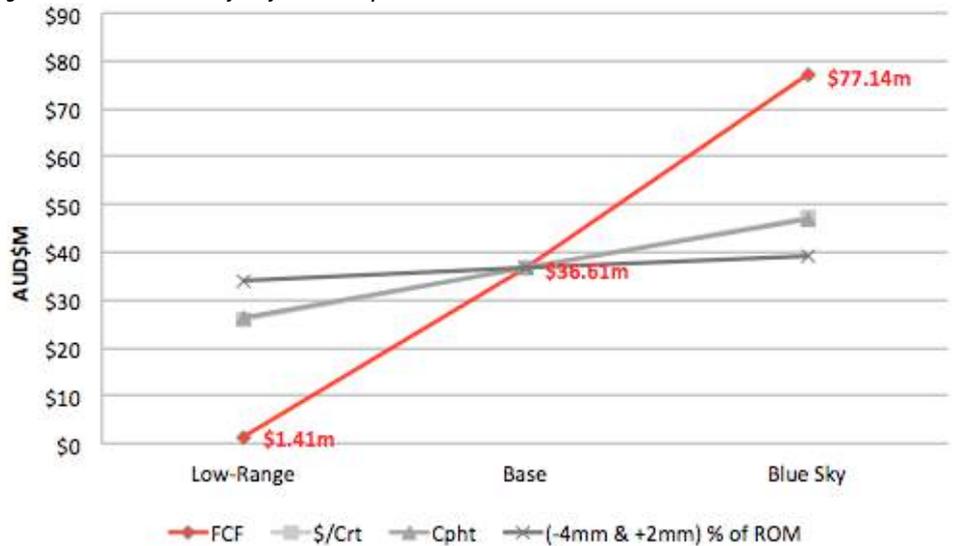
FINANCIALS

SENSITIVITY ANALYSIS

Figures 21 & 22 display various sensitivity scenarios to demonstrate the feasibility and robust nature of the Merlin operation. Three different scenarios were calculated; a low range model, a base model and a blue-sky model. Empire wanted to demonstrate that even with ultra-conservative assumptions, Merlin still generated substantial free cash flow. The differing assumptions for the three scenarios include:

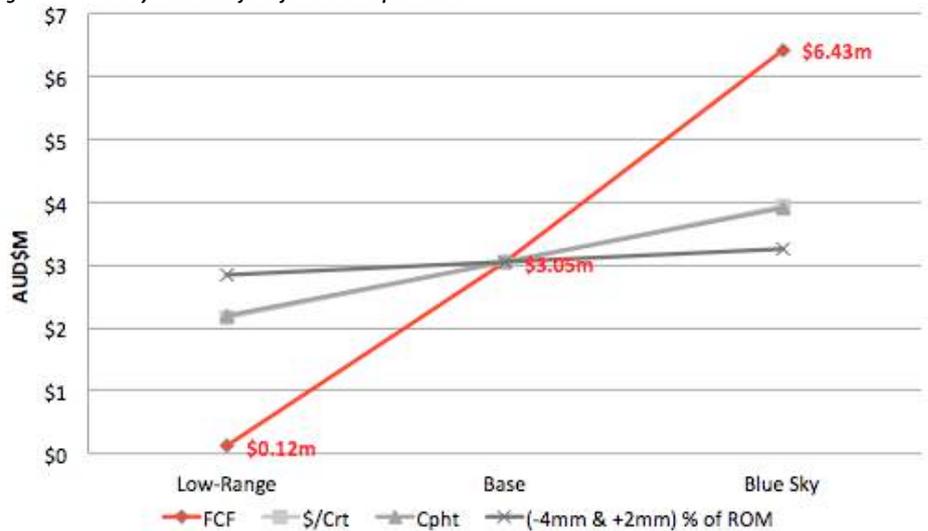
- **Low Range Scenario:** Average grade – 15cpht, Price/carat – USD\$225/ct to generate AUD\$0.12M monthly free cash flow and AUD\$1.41M annual free cash flow.
- **Base Scenario:** Average grade – 25cpht, Price/carat – USD\$300/ct to generate AUD\$3.05M monthly free cash flow and AUD\$36.61M annual free cash flow.
- **Blue-sky Scenario:** Average grade – 35cpht, Price/carat – USD\$350/ct to generate AUD\$6.43 monthly free cash flow and AUD\$77.14M annual free cash flow.

Figure 21: Annual Free Cash flow for Merlin Operations



Source Company Reports, Empire Estimates

Figure 22: Monthly Free Cash flow for Merlin Operations



Source Company Reports, Empire Estimates





PROJECT UPSIDE

Empire has identified the following project upsides to the Merlin operation:

- **Large diamond recoveries:** In order to maintain Empire's conservation assumptions in the above financial forecasts for the Merlin Project, large specials recovered through the XRT machine have been exempted from the analysis. Both the Company and Empire anticipate a substantial revenue stream from recovered large specials, with the Merlin kimberlite pipes demonstrating time and time again their potential for large diamond recoveries. The financial forecasts have therefore been limited to diamonds recovered through the DMS module in the +2mm -4mm and +4mm -20mm size fractions.
- **Exploration upside:** The immediate Merlin Orbit area remains highly prospective for diamond bearing kimberlite pipes. Merlin has identified over 80 near mine targets within its tenement area with 6 targets being drill ready. Merlin believes that the data density of current geophysical surveys and diamond indicator sampling over the Merlin plateau could easily have missed pipes the size of Ywain and Gawain, Merlin's highest-grade kimberlite pipes.
- **Pipe Depths:** While further exploratory drilling of Merlin's kimberlite pipes has not been conducted, Empire are confident the pipes, especially Palomdies and Sacramore, continue under depth further than indicated in the JORC resource. This would provide a huge upside for the Merlin Project with the chance for the LOM to be extended past 15 years on discovery.
- **Price Potential:** The kimberlite pipes in Merlin's northern cluster; Gareth, Kaye and Ector have a higher proportion of champagne and cognac diamonds at around 60%. The remaining 40% consist of white diamonds (35%) and coloured stones (5%). Any increase in price of champagne and cognac diamonds would certainly result in a substantial increase in free cash flows and therefore warrant a reassessment of financial forecasts. With the Argyle Diamond mine holding the monopoly on champagne diamonds, its near-term potential closure in 2021 could see a consequential increase in these diamond prices, due to the irreplaceable removal of diamonds from the global market.





PLAN & OUTLOOK

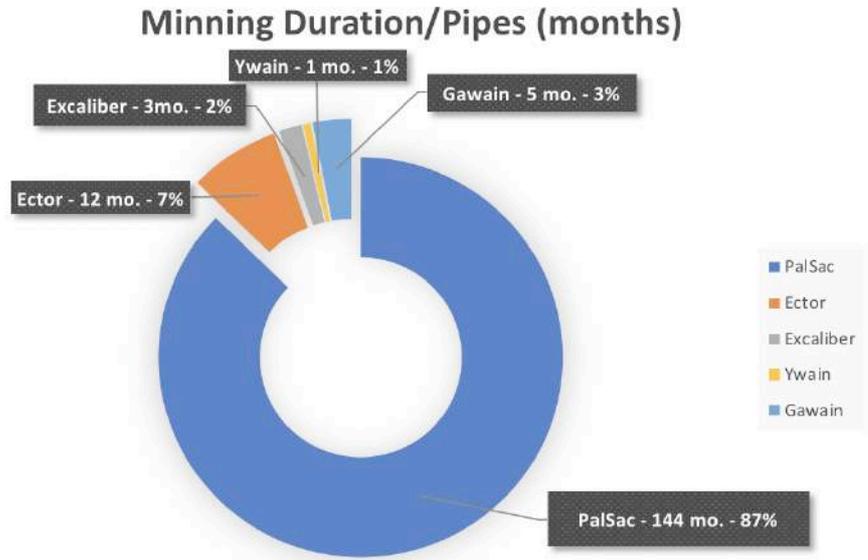
MINING SCHEDULE

Once in full time operation, the Company anticipates spending the majority of its operations (144 mo. – 87%) mining the Palomides and Sacramore pipes - Figure 23. Merlin forecasts the following milestones for its mining operations:

- Q3 2018: Rusca Bros. commence full time mining operations, beginning at Gawain.Q4
- Q4 2018: New plant equipment (DMS module & scrubber/trommel) arrives from China and South Africa.
- Q4 2018*: Mining ends at Gawain and commences at Ywain.
- Q4 2018*: Mining ends at Ywain and commences at Excaliber.
- Q1 2019*: Mining ends at Excaliber and commences at Ector.
- Q1 2020*: Mining ends at Ector and commences at PalSac

**Please note, this order is subject to change and should be used as a guide only*

Figure 23: Merlin’s Anticipated Mining Duration per Pipe (based on JORC Figures, does not include new diamond discoveries)



Source Company Data, Independent Analyst Research





DIAMOND MARKET - OVERALL PERFORMANCE FOR 2017/18

GLOBAL SUMMARY

On the back of 2017, a year in which global diamond supply by volume increased by 11.7% year-over-year, supply is forecast to contract by 3.4% to 147M carats in 2018

Out of the world's top three diamond miners by volume, only De Beers is expected to increase production this year, while diamond output at Russia's Alrosa (**MICEX: ALRS**) and diversified-major Rio Tinto (LSE: RIO) is estimated to decline, more than offsetting De Beers' increase. Combined, the three companies represent approximately 70% of global diamond supply by volume.

SUPPLY/DEMAND

With global diamond production expected to decrease in 2018 along with producer inventories at multi-year lows, a demand increase should allow for diamond price upside. A 2-4% increase in diamond demand is quite possible this year given the backdrop of a strong global economy, healthy U.S. consumer sentiment, signs of a stronger Mainland Chinese market, and the Diamond Producers Association increased budget fuelling the return of generic diamond marketing.

RISKS

Looking forward to the remainder of 2018, demand estimates could disappoint if tighter-than-expected economic policies in developed economies push interest rates higher than expected, resulting in downward revisions and de-risking of financial markets, which could negatively impact consumer sentiment and discretionary purchasing power. More specific to the diamond industry, primary medium and longer-term risks include an acceleration of trends already negatively impacting demand, such as changes in social norms and consumer appetite, for example decreasing marriage rates and changing consumer preferences of younger generations.

POLISHED DIAMONDS

The polished diamond market has continued its positive momentum through January and February, off the back of an awakening demand towards the end of 2017. The demand, fuelled by improved retail sales in the US during the Nov-Dec holiday season, caused polished diamond prices to improve, which have been suffering from an extended period of declining prices since mid-2014. During the course of February, prices of smaller goods, as well as one and two caraters, experienced improvements in price however, a few key sizes pulled back, according to the Mercury Diamond Global Tracker (MDGT™), which is an index of collected and used polished diamond transaction prices. The steadying of the diamond prices is a welcome sign of stability for the global diamond industry, especially after an extended period of price declines.

Figure 24: Mercury Diamond Global Price Tracker (1-30ct diamonds)



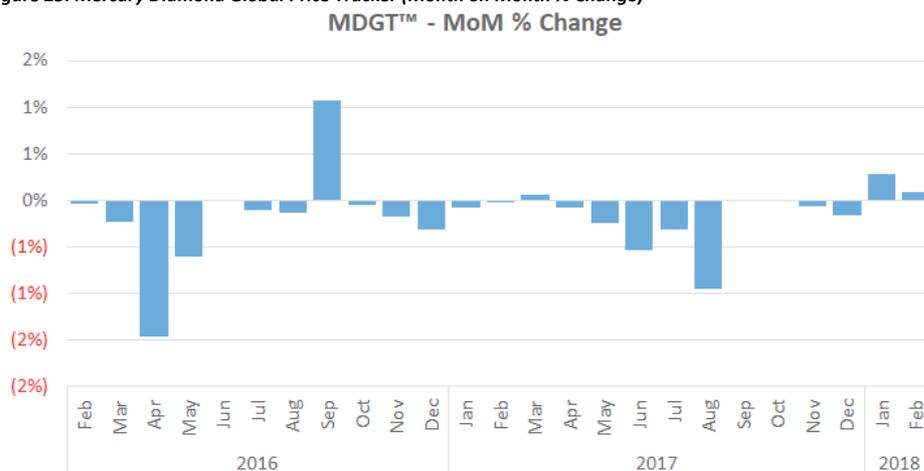


DIAMOND MARKET - OVERALL PERFORMANCE FOR 2017/18

POLISHED DIAMONDS CONT.

The past 2 years have seen the overall polished diamond prices increase only occasionally on a month-to-month basis. In 2017, prices were especially weak over a four-month stretch between May and August. This period consisted of a slowdown in sales and demand that hurt the diamond industry substantially, to a degree that multiple companies were taken to the brink. Despite the trends returning to a more stable state, caused by good consumer demand in December, shortages in the wholesale market and the edging down of year-over-year declines – the diamond industry is still not yet in the clear. For that to occur, the diamond market has to see robust consumer demand over the course of the whole year.

Figure 25: Mercury Diamond Global Price Tracker (Month on Month % Change)



Source Mercury Diamond™

ROUGH DIAMONDS

Rough trading was quiet in December and at the beginning of January. There were fewer goods on the market, as there was a relatively long wait between the two sales cycles. Rough demand was projected to rise at the Alrosa contract sale and De Beers sights — which occurred in late January during or after press time — since polished inventories diminished over the holiday season. Manufacturers have maintained factory operations at an estimated 60% to 80% of full capacity, particularly among the smaller companies. That has led to pent-up demand for rough, and a firming of prices on the dealer market.

Mining companies saw lower sales in 2017 due to a drop in the average price of goods sold, and despite an increase in the volume of rough they produced. There was a rise in demand for smaller and lower-quality goods throughout the year, after manufacturers avoided those goods in late 2016 due to squeezed liquidity following the Indian government's demonetization program. De Beers' rough sales fell 5% to \$5.3 billion for the year, while Alrosa's rough sales declined 5% to \$4.27 billion, according to Rapaport projections.

COLOURED DIAMONDS

The overall price trend in the coloured diamond market shows another flat year for yellow diamond growth, with even a slight decrease. Overall the price of pink diamonds has remained stable with the top performer for the sector being blue diamonds, which experience significant price growth over the course of the year. The price behaviour for all of the diamond colours is related to the rarity factor and the basic tenets of supply and demand. Demand for pink diamonds and blue diamonds continues to increase, while simultaneously, new supply of pink diamonds and blue diamonds is essentially non-existent. The majority of the supply of rare blue diamonds and pink diamonds that appear in auctions, are pre-owned diamonds and not newly mined.

Rio Tinto hopes to address the surge in demand in China through its Argyle mine in Western Australia. Argyle's multi-coloured diamonds available in rare red, blue and pink created a buzz when it debuted in Hong Kong. The coloured gems are being preferred by more Chinese since they are an alternative to the usual large white gems.





DIAMOND MARKET – FOREWORD LOOKING STATEMENT

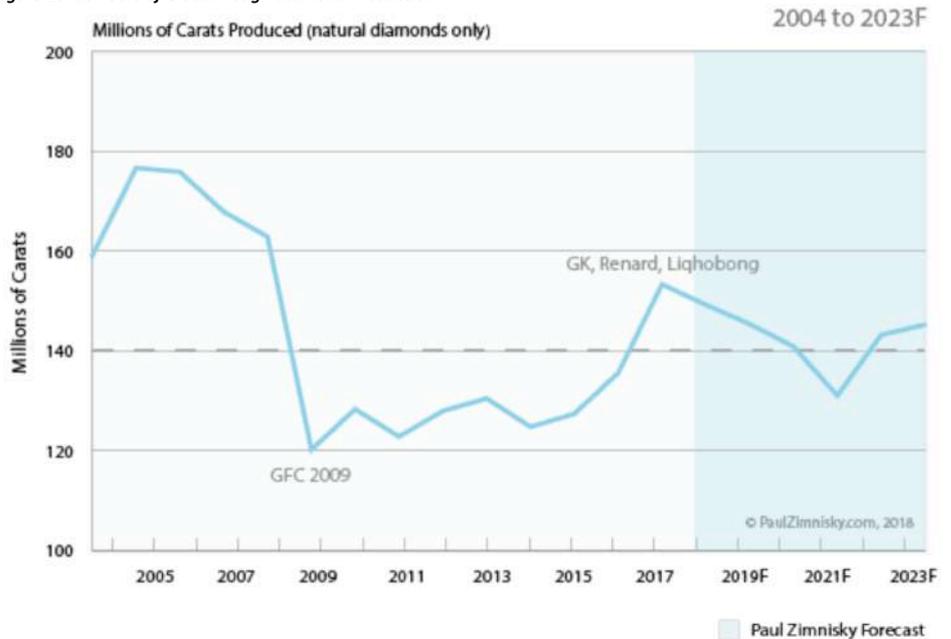
Rough diamond prices are on the rise and expected to keep an upward trajectory throughout the forecast period (2018 – 2021). According to well-regarded global diamond analyst, Paul Zimnisky;

“The positive outlook for global diamond markets will definitely move the needle for production companies”

Zimnisky is predicting prices to rise by 10% cumulatively over the forecast period, against backdrop of a strengthening global economy, no major global economic disturbances, signs of a stronger Mainland Chinese market, and the Diamond Producers Association increased budget fueling the return of generic diamond marketing. This bodes well for Merlin, who will experience an increase in operating margins and free cash flow if diamond prices increase and operating costs stay the same.

A catalyst for further increase in diamond prices will be the potential closure of Rio Tinto’s Australia-based Argyle diamond mine, scheduled for 2021. With Argyle supplying 9 out of 10 pink diamonds on the global market and “vast majority” of cognac diamonds, the closure will see a significant amount of those diamonds removed from the market. The closure of Argyle, along with the increasing demand from China and India as well as celebrity uptake, will most likely result in a substantial increase in diamond prices - especially cognac and pink.

Figure 26: 20 Years of Global Rough Diamond Production



Source Government data, Paul Zimnisky analysis and forecasts



RECENT NEWSFLOW

Merlin released its quarterly activities report for period ended 31 March 2018 on 30 April 2018. The relevant points have been summarized below.

DIAMOND PRODUCTION

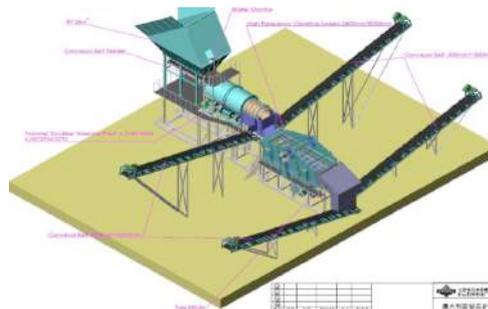
For the period ending 31 March 2018, Merlin announced the following diamonds recovered:

- A 7.313ct fancy yellow diamond and a 1.448ct blue/green diamond were recovered, along with 6 pink diamonds, the largest being .28ct and the total pink diamonds recovered weighed 1.03ct and,
- Over 1000 diamonds have been recovered from stockpiles on the ROM.

ENHANCED OPERATIONS

In order to increase production throughput and efficiency, the Company has ordered and are awaiting delivery of, a new scrubber/trommel and a new DMS (Dense Medium Separation) module. With the arrival of the new scrubber/trommel, Merlin anticipates a streamlined mineral recovery process by taking a top-grade scrubber and adding a high-performance screening and sizing trommel onto the end of it. Material will be separated into three different size fractions early in the upstream process resulting in an increased head feed from the current 50tph to 100tph through the scrubber.

Figure 27: New Scrubber & Trommel Wash Plant



Source Company Announcements

With the additional DMS module from South Africa, Merlin is anticipating an increase in the +2mm -18mm production rate from 15tph to 40tph. Combined, with Merlin's already up-and-running DMS module, the installation of the new DMS module will result in a continuous recovery circuit, even in spite of unplanned breakdowns or maintenance checks.

Figure 28: New DMS Module



Source Company Announcements

CORPORATE

BOARD OF DIRECTORS



MR. JOSEPH GUTNICK | EXECUTIVE CHAIRMAN, DIRECTOR

A leading mining industry entrepreneur, Mr. Gutnick is the President/Chairman and CEO of the Gutnick Network of Companies. He was responsible for overseeing the discovery of the Plutonic 11-million-ounce gold deposit and the discovery, development and operation of the world class Bronzewing and Jundee gold mines in Australia. Mr. Gutnick is a Fellow of the Australian Institute of Mining and Metallurgy, a Fellow of the AIM, a Member of the Institute of Company Directors in Australia, and a former Director of the World Gold Council. He was awarded the prestigious Diggers award at the 1997 Diggers and Dealers Industry Awards.



MR. MORDECHAI GUTNICK | CEO

Mr. Gutnick is a businessman and long-term investor in the mining industry. He has served a project advisor to the mining industry for over 10 years. He was appointed a Director in July 2016. He is a director of Consolidated Gems Inc. and Golden River Resources Corporation and was formerly a Director of Quantum Resources Limited, Legend International Holdings, Inc. and Top End Minerals Limited.



MR. HENRY HERZOG | NON-EXECUTIVE DIRECTOR

Mr. Herzog has more than 40 years of corporate and management experience. He has been a Director of the Company since December 2009. Mr. Herzog has served in various positions as President, Vice President or Director of a number of publicly listed companies in Australia and the United States, predominantly in the mining sector and is currently also a Director of Legend International Holdings, Inc. Mr. Herzog was responsible for the restructuring and reorganization of several publicly listed companies including Bayou International Limited, now known as Golden River Resources Corporation, where he served as its President and Chief Executive Officer from 1986 - 1988 and as a Vice President from 1988 - 1989. For at least the past five years, Mr. Herzog has also been managing a number of private investment entities. He is also a member of the Board of Trustees of a non - profit college of higher education.



DR. DAVID TYRWHITT | NON-EXECUTIVE DIRECTOR

Dr. Tyrwhitt has a long history in the diamond exploration industry dating back to 1959 when De Beers in Tanzania first employed him as a diamond exploration geologist. He was the Chief Executive Officer and Managing Director of Ashton Mining Ltd from 1988 to 1991 where he was involved in the exploration and feasibility of diamond deposits in the Northern Territory and Australia (including Merlin), the development of the Argyle alluvial through the Argyle joint venture, diamond exploration in Scandinavia, feasibility of the Cempaka alluvial diamond project in south east Kalimantan Indonesia, and key negotiations and contractual matters for Argyle Diamonds. Since leaving Ashton Mining, he has been involved in diamond exploration in Canada, China and Australia. Dr. Tyrwhitt was chairman of JORC and during his chairman ship, introduced the diamond reporting code. Appointed 2011.



CORPORATE

BOARD OF DIRECTORS



MR. PETER LEE | CFO & COMPANY SECRETARY

Mr. Lee is a Member of the Institute of Chartered Accountants in Australia, a Fellow of Chartered Secretaries Australia Ltd., a Member of the Australian Institute of Company Directors and holds a Bachelor of Business (Accounting) from Royal Melbourne Institute of Technology. He has over 30 years commercial experience and is currently a Director, Chief Financial Officer and Company Secretary of several listed public companies in Australia and a Director, Chief Financial Officer and Secretary of a US Corporation listed on the over the counter market in the USA, Chief Financial Officer and Secretary of a further three US Corporations listed on the over the counter market in the USA and a Director of a company listed on the Toronto Stock Exchange.

SUMMARY

Merlin Diamonds is a diamond focused mining and exploration company located in Australia's Northern Territory. The Company presents a compelling investment opportunity, as a speculative buy with the second half of 2018 shaping up to be a highly profitable period for the Company. Merlin is anticipating significant streams of revenue, as of Q3 '18, with the commencement of full-scale mining operations.

EMPIRE CAPITAL RESEARCH RECOMMENDATION

Care has been taken to define the level of risk to return associated with a particular company. Our recommendation ranking system is as follows:

Buy	Companies with 'Buy' recommendations have been cash flow positive for some time and have a moderate to low risk profile. We expect these to outperform the broader market.
Speculative Buy	We forecast strong earnings growth or value creation that may achieve a return well above that of the broader market. These companies also carry a high to very high level of risk.
Hold	A sound well managed company that may achieve market performance or less, perhaps due to an overvalued share price, broader sector issues, or internal challenges.
Sell	Risk is high and upside low or very difficult to determine. We expect a strong underperformance relative to the market and see better opportunities elsewhere.

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