

North Australian Diamonds

Buy NAD around 5 cents

An emerging diamond producer

[Fat Mining 44](#), 27 Sep, 2006
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SYMBOL DEFINITIONS

 EXPLORER	 HIGH RISK	 MARKET CAP	\$45 million
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North Australian Diamonds is an emerging diamond producer, with a comprehensive plan for diamond production from the Merlin Field in the Northern Territory. NAD believes it has learnt from past mistakes committed by previous owners of the field and that modern techniques can significantly boost diamond recoveries and enhance project economics. It is now into Stage 2 of a staged Merlin development plan, backed by a board and management team crammed with diamond industry expertise.

"The company is well down the road of developing only our third commercial diamond operation."

Gains over the past year reflect growing investor support for NAD. This represents a clear turnaround following six years of decline during which the stock fell more than 90%.



Since the June low of 3.7 cents, NAD has rallied more than 45% to post a high of 5.4 cents. Following such a firm advance, it is common for signs of rally fatigue to emerge. However, in the case of NAD, we believe that any pause in the upward trend will be temporary.

In the months ahead, we expect to see NAD extend the rally above 5.4 cents to challenge the April high of 5.7 cents. As can be seen on the weekly chart, a break above 5.7 cents would confirm resumption of the 12-month upward trend with substantially higher levels achievable in time, in our opinion.

North Australian Diamonds is part of an extremely rare species, known as an Australian diamond producer. By our count, Rio Tinto's Argyle operation and Kimberley Diamonds' Ellendale operation are the only two significant producers of diamonds currently in Australia.



What attracted us to NAD is the strategic plan the company has in place to reactivate commercial diamond production from the Merlin diamond field in the Northern Territory. We met recently with the company's Managing Director, Alan Campbell.

The Merlin Diamond Project comprises the former Merlin diamond mine operations and the surrounding exploration tenements comprising around 3,000 sq km. This area effectively encompasses the currently known extent of the Merlin Kimberlite Field. This acquisition built on the Merlin Orbit exploration tenements previously acquired from Rio Tinto.

The project lies 75km south-southeast by road from McArthur River and 720km southeast of Darwin in the Gulf Region of the Northern Territory. The Merlin Mining Lease encompasses 11 of the 13 known kimberlite pipes (of which 9 were subject to open-pit operations), producing approximately 500,000 carats of diamonds at an average value of US\$108 per carat.

The project hosts a combined Indicated & Inferred Resource of 19.1 million tonnes of kimberlite grading 17 carats per 100 tonnes, for 3.3 million carats of contained diamonds.

It is interesting to note that the largest diamond ever recovered from the Merlin Diamond Field was 104.73 carats. It was valued at around US\$525,000 at the time and remains the largest diamond recovered in Australia.

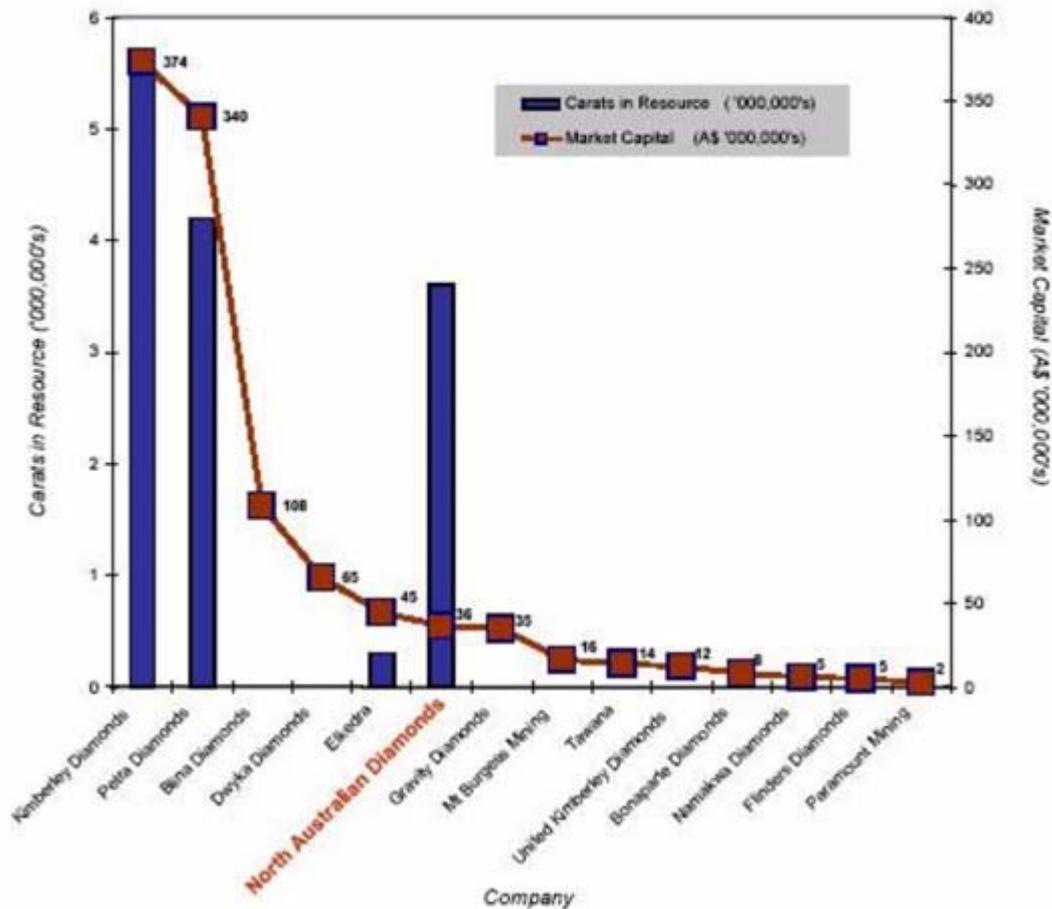
The company commissioned AMC Consultants to undertake a Scoping Study to evaluate the economic of open pit and underground mining of several of the kimberlite pipes. Based on geotechnical analysis, AMC examined a range of practical underground methods for their suitability for economic extraction of diamond-bearing ore from the pipes.

The Study incorporated new information gained from a recently completed drilling program, as well as significant diamond price increases experienced since the closure of the mine in 2003. The Scoping Study also incorporates grades based on the expectation of improved liberation and recovery of the diamonds.

AMC's brief was to identify a potential mining project and to estimate the cost of appropriate mining techniques.

Due to an often-significant discrepancy between the recovered mining grades and higher-grade expectations from early bulk sampling undertaken by Ashton Mining, NAD undertook investigations into the recovery efficiency of the previous mining operation

NADL: Under-valued vs Peers



Recent sampling work of sorthouse and other tailings at Merlin reported significantly improved diamond recoveries compared to those obtained during previous mining operations conducted by Ashton Mining.

Testing confirmed the presence of significant numbers of non-fluorescent octahedral-shaped diamonds that would not have been recovered using standard x-ray sorting techniques.

NAD tested various mine tailings including the x-ray sorthouse for commercial diamonds, with the aim of identifying and if possible quantifying any diamond losses.

An examination of previous recovery operations by the examination of waste material left behind shows significant diamond losses took place across a whole range of diamond sizes. Work to date indicates these losses may have exceeded 25%.

The test results support the premise that NAD can improve diamond grades if it can resolve issues related to diamond liberation and recovery. NAD recovered diamonds of substantial size from the waste material, including diamonds of 14 carats, 11 carats and 10 carats in size.

The AMC Scoping Study indicates there is the potential for an economic mining operation, based on the expectation of improved recoveries due to better liberation of the diamonds and improved diamond recovery techniques.

Stage 1 of project development involved the processing of 2,900 tonnes of diamondiferous ore that recovered 13,360 carats worth of diamonds. Most importantly, the testwork confirmed the procedures for improved liberation and recovery of diamonds from the kimberlite.

In Stage 2, NAD will source ore from tailings stockpiles, previously mined pits and revised pit designs.

Stage 2 resources comprise around 502,000 tonnes for 197,000 carts of contained diamonds. NAD will source the diamonds from four pipes, Ywain, Gawain, Gareth and Kaye. The Heavy Media Separation (HMS) plant is in production and is capable of processing up to 400,000 tonnes per annum (tpa) of ore.

AMC's study anticipates that based on diamond value of US\$140 per carat and a US\$/A\$ exchange rate of \$0.78, the Stage 2 project could produce a surplus cash flow of \$8.1 million over a two year project life.

Under a possible third stage, the company will investigate the feasibility of undertaking a large cutback on the PalSac pipe, along with other pits. Based on current anticipated diamond values and exchange rates, 1.7 million tonnes of kimberlite containing around 380,000 carats is possible from the PalSac pit alone. This would also entail the upgrading of the processing plant to 1 million tpa capacity to achieve economies of scale.

A possible fourth stage operation would involve an underground operation that could provide a further 10.1 million tonnes of diamond-bearing ore containing 2.36 million carats over a 10-year mine life.

What is tremendously important in our view is the quality of the company's Board, which incorporates tremendous diamond industry experience predominantly sourced from the old Ashton Mining.

Chairman Ewen Tyler is the leading figure in the Australian diamond industry, being previously involved in the discovery of the Ellendale and Argyle diamond mines. Managing Director Alan Campbell has 20 years diamond industry experience, predominantly with De Beers, while other key directors Bill Duchatel, Tom Reddcliffe and Glenister Lamont, were all key executives with Ashton Mining.

Besides Merlin, the company boasts an extensive Arnhem Land tenement portfolio. This includes a farm-in agreement with De Beers Exploration Australia to earn a 100% stake in tenements covering a total area of 13,500 sq km. The Arnhem Land tenements that now encompass an area of more than 21,000 sq km are located 400km north of the Merlin Kimberlite Field. These tenements have potential for other minerals, as well as diamonds.

We believe NAD with a market cap of just 45\$ million represents a relatively cheap exposure to what could be a quite lucrative diamond development at Merlin. Importantly, the company appears to have a well thought out development strategy to commercialise Merlin and a high quality board to execute its plans. We believe the upside for Members is quite exciting.

We recommend NAD as a Buy to all Members around 5 cents.

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