

Kimberley Diamonds Ltd

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1 BACKGROUND

Kimberley Diamonds Ltd (**KDL**) (ASX: KDL) is the owner of the Lerala Diamond Mine (**Lerala Diamond Mine**), located in north-eastern Botswana. Lerala was acquired by KDL in February 2014 when KDL acquired 100% of the issued share capital of Mantle Diamonds Mines Ltd (**Mantle**).

The Lerala Diamond Mine comprises a cluster of five diamond-bearing kimberlite volcanic pipes, designated K2 to K6, and a processing plant with a nominal capacity of 200 tonnes per hour (tph). The project area is covered by a 15 year fully permitted mining lease with an area of 21.86km².

Mantle operated the Lerala Diamond Mine between February and July 2012 but a range of technical factors in the processing plant resulted in poor recovery of diamonds and Mantle ceased operations. Following its acquisition of the Lerala Diamond Mine, KDL's Botswana subsidiary, Lerala Diamond Mines Limited (**Lerala**) engaged Consulmet Pty Limited (**Consulmet**), a leading South African process engineering company with extensive diamond plant experience, to redesign sections of the processing plant to facilitate improved diamond recovery and throughput reliability.

Lerala engaged Basil Read Botswana (Pty) Limited (**Basil Read**) to undertake open pit mining operations and Basil Read commenced mining at the Lerala Diamond Mine in early April 2016. Consulmet then commenced the commissioning of the plant in early Q4, 2016 and production commenced shortly thereafter.

The first sale of diamonds from the Lerala Diamond Mine occurred on 28 June 2016.

Elsewhere in Botswana, KDL holds through Lerala a 50% interest in two exploration tenements through a Joint Venture with Tilwane Services (Pty) Limited in which it holds a right to earn an additional 20% interest. KDL also holds through its subsidiary Mantle, interests in diamond tenements in Canada.

In gold and copper-gold, KDL was awarded the Investigation Permit covering the former Lomero mine in Andalucia, Spain in October 2014. In August 2016, KDL entered into a joint venture with Winmar Resources Limited in relation to the Lomero project.

2 LERALA DIAMOND MINE UPDATE

2.1 MINING AND PRODUCTION

Quarterly Mining and Processing Results

Mining was suspended early in the quarter however during Q2 2017, Basil Read mined and hauled 26,054 tonnes of ore to the ROM pad.





During Q2, 2017, 125,381 tonnes of ore were processed through the plant at the Lerala Diamond Mine, with 23,477 carats recovered. Major delays were experienced late in the quarter due to breakdowns on crushing equipment as well as a lack of availability of long lead spares items.








A lack of water from the Seleka wellfield due to the prolonged drought in Southern Africa impacted on operations during later November and into December, however heavy rains late in December throughout the Limpopo River catchment area replenished the wellfield and relieved the water issues. These same rains have caused additional delays however due to wet sticky feed material causing delays at the headfeed.

Performance Improvement Plan

A number of important plant design modifications and issues were identified during the commissioning period and work has been ongoing, funding permitted, to systematically resolve these issues. While several of these issues have been addressed, unfortunately due to funding restrictions, significant impediments to full production remain and these are being addressed as funds become available. Progress has been summarised against these targets in the following table as complete, in progress but not complete or not yet started.

Engineering solutions have been identified for each of the plant problem areas and provided funds are available, the operational team are confident that these issues can be resolved.

Current Issue	Proposed Solution	Cost	Completion	
Large rocks blocking the head feed reception bin causing overloading on the Vibrating Grizzly Feeder	Install new Vibrating Grizzly Feeder structure at primary crusher to minimise plant downtime	Paid	31 st August	
Fine diamonds reporting to recovery tailings stockpile due to inefficiencies in the DMS yield and Flowsort X-ray machines	Re-commission on-site CDX X-Ray sort machine to retreat the recovery tails as an audit facility	A\$ 50,000	15 th September	
Pre-existing 6/4 DMS feed pumps under spec'd for required throughput performance	Install new 8/6 feed pumps to stabilise pressures and density cut points within the cyclones	Paid	30 th September	
Large rocks reporting to the DMS causing excessive wear and DMS feed pump blockages	Install a screening solution after the secondary scrubber to recycle oversized material to the existing tertiary crusher before it reaches the DMS	A\$ 150,000	15 th October	
SUB-TOTAL		A\$ 200,000		

Current Issue	Proposed Solution	Cost	Completion
Excessive spillage from conveyor belts causing frequent power trips and plant downtime	Installation of self tracking idlers, improved chute skirting and belt scrapers	A\$ 220,000	30 th October 
Pre-existing concrete support structure being excessively vibrated by the new secondary crusher	Stabilise secondary crusher concrete housing structure	A\$ 200,000	30 th October 
Spares required for Jaw Crusher and Scrubbers	Purchase spares for critical pieces of equipment to minimise maintenance and repair downtime	A\$ 350,000	30 th October 
Leaking and blockages of slimes delivery line	Add high pressure pipes to slimes line. Introduce slimes maintenance team to improve pipeline monitoring	A\$ 80,000	15 th October 
Process Water Dam liner leaking	Reline dams, purchase new high volume diesel pump for slimes dam / K6 return water.	A\$ 240,000	30 th November 
Damage to chutes, plates and ceramic tiles within the DMS module	Repair and replace	A\$ 130,000	31 st December 
High wear rates on critical parts	Purchase additional critical spares to minimise operational downtime	A\$ 150,000	31 st December 
SUB-TOTAL		A\$ 1,370,000	
TOTAL ALTERATIONS, REPAIRS & SPARES		A\$ 1,570,000	

In-pit Mining Suspension

Mining operations at the Lerala Diamond Mine, which are conducted by external contractor, Basil Read, were suspended early in the quarter due to excessive stockpiles of ore being available. Mining operations remain suspended at the end of the quarter.

This is a cost saving measure while Lerala implements the performance improvement plan, and is not anticipated to impact on our expected production levels.

2.2 DIAMOND SALES

Lerala has entered into an offtake agreement for the sales of diamonds from its Lerala Diamond Mine from September 2016 to February 2017.

Lerala conducted a tender of its diamonds in late September 2016, which was operated by DDA Trading BVBA in Antwerp. Following the tender, the winning bidder, Alpha Capital (Pty) Ltd, trading as Capital Diamonds (**Capital**), a Botswana based company, made an offer to enter into an offtake agreement for all diamonds for a 6 month period. Capital agreed to purchase all run of mine diamonds produced by Lerala at its Lerala Diamond Mine from 1 September 2016 to 28 February 2017, at prices consistent with KDL and Lerala expectations and recent forecasts.

On 1 November 2016, KDL announced that Alpha Capital had failed to comply with the payment terms under the offtake agreement, despite Alpha defaulting on the agreement the Company insist that Alpha uphold the agreement. However, the Company is working on alternative solutions in parallel. To date the Company is yet to finalise an offtake agreement for the Lerala Diamonds, however DDA is pursuing possible contract sales with various parties in February. DDA, an exclusive marketing agent for Lerala, continues discussions with a number of parties in relation to offtake of Lerala production after February 2017.

3 CORPORATE

3.1 FUNDING

Financial Position

At 31 December 2016, KDL had a cash position of A\$0.1M and a further A\$0.3M in restricted deposits and debt of A\$23.5M. A\$11.3M of this debt matures in May 2017.

As previously announced, KDL has been looking to raise further funds to implement the performance improvement plan at the Lerala Diamond Mine and for working capital. During Q2 2017, KDL took the following steps to raise funds required, and remains in discussions with external parties for further funds:

Share issue

On 12 October 2016, KDL issued 8,333,333 shares at A\$0.06 per share, raising A\$500,000 from a sophisticated investor. These shares were issued with shareholder approval under ASX Listing Rule 7.3, with approval obtained at the EGM on 27 September 2016.

Loans from third parties

During the Quarter, KDL obtained the following loans from third parties:

- a loan for USD\$450,000, repayable by 17 October 2017, which has an interest rate of 5% per annum and is secured under the terms of a security deed;
- a loan for A\$464,303, repayable by 30 April 2017, which has an interest rate of 10% per annum;
- a loan for USD\$1,616,133, repayable by 1 December 2017, which has an interest rate of 21% (with the exception of 1 tranche of USD518,466 which is at 24%)
- a loan for USD\$1,065,909, repayable by 30 December 2017, which has an interest rate of 10%

3.2 CHANGES TO KEY MANAGEMENT PERSONNEL

KDL announced the following changes to its key management personnel during the Quarter:

- Noel Halgreen, previously Managing Director of KDL, has resigned from the Board and will be leaving KDL in 6 months after serving out his notice period as a consultant;
- Alex Alexander becomes Executive Chairman during the transition stage, while KDL searches for a suitable replacement for the role of Managing Director; and
- Brett Thompson, KDL's current Chief Technical Officer, has been appointed to the newly created role of Chief Operating Officer, and will be responsible for all mining, operations and corporate functions of the Company and its Botswana subsidiary, Lerala Diamond Mines Limited.

3.3 APPLICATION FOR REMOVAL FROM OFFICIAL LIST OF THE ASX

On 14 November 2016, KDL lodged an application with the ASX for removal from the official list of the ASX. The reasons for the application included the following:

- KDL's shares are trading at a price which is materially lower than the underlying value of the company's assets, based on independent valuation.
- Low liquidity in KDL shares.
- Lack of interest for KDL shares in the Australian market.
- The Directors believe that further fundraising, including any required restructuring of existing loans, is more likely to be successful if the company is delisted.
- Removal from official list will provide significant cost savings.

On 23rd December, the ASX confirmed that KDL would be permitted to delist, subject to the following conditions being satisfied:

1.1. The Company's removal from the official list of ASX is approved by ordinary resolution of ordinary security holders of the Company.

1.2. The notice of meeting seeking security holder approval for the Company's removal from the official list of ASX must include a statement (i) to the effect that the removal will take place no earlier than one month after approval is granted and (ii) containing full particulars of the Company's outstanding loans and those that require restructuring in the short term (including the proposed restructuring terms).

1.3. The Company releases the full terms of this decision to the market immediately upon the Company's directors resolving to seek removal of the Company from the official list of ASX.

An extraordinary general meeting is scheduled for 20th February 2017 and we refer shareholders to the Notice of Meeting, available on our website, for further information.

3.4 MATTERS SUBSEQUENT TO THE END OF THE QUARTER

On the 19th January 2017, the Company commenced a voluntary suspension of the Company's securities from quotation.

On the 23rd January 2017, the Company announced that it has undertaken a private placement of shares to raise further funds.

- 28,064,165 shares have been issued to a private investor raising approximately \$560,000 at an issue price of \$0.02 per share; and

- 14,265,950 shares at \$0.02 per share issued to Zhejiang Huitong Auction Co Ltd (or its nominees), in full satisfaction of the outstanding interest due on its loan to KDL.

These share issues have been made using KDL's full 15% placement capacity under Listing Rule 7.1 and 10% placement capacity under ASX Listing Rule 7.1A.

KDL is also undertaking a non-renounceable pro-rata rights issue offer of new KDL ordinary shares (New Shares) at an issue price of \$0.02 per New Share (Issue Price) to raise up to approximately \$3,386,409 (Offer).

Eligible shareholders will be able to purchase 1 New Share for every 1 existing KDL ordinary share held as at 5.00pm (Sydney time) on 1 February 2017 (Record Date). New shares issued under the Offer will rank equally with existing KDL ordinary shares from issue.

To be an eligible shareholder, you must, as at 5.00pm (EST) on the Record Date:

1. Be registered as a holder of KDL ordinary shares; and
2. Have a registered address in Australia or New Zealand.

4 EXPLORATION ACTIVITIES

4.1 DIAMONDS

Tilwane Joint Venture

KDL, through its wholly owned subsidiary, Lerala Diamond Mines Limited, has now earned a 50% right in the Tilwane Joint Venture, a greenfields kimberlite exploration project in Botswana located some 60km to the east of the large scale Orapa and Letlhakane diamond mines. At 31 December 2016, approximately A\$162,000 had been expended in exploring the property since KDL has held an interest in the Tilwane Joint Venture. Exploration has focused on geophysical surveys and geochemical analyses, and has identified a number of significant targets deserving of further attention. No additional funds have been expended in the quarter under review.

KDL has the opportunity to earn an additional 20% interest in the Joint Venture by spending a further A\$1 million on project expenditure in the period to early 2017. If it completes this expenditure, it will hold a 70% interest in the Joint Venture. If it does not, and if the parties do not agree to an extension, it will be deemed to withdraw from the joint venture. The next phase of exploration at Tilwane is logically a drilling program designed to test the identified targets. The drilling programme had been expected to be undertaken during calendar 2016, however given the extended focus on ramping up production at Lerala, this may be delayed and the market will be kept informed as to when this will proceed.

Until there is an opportunity to re-focus on the Tilwane greenfields exploration project, one of our local joint venture partners in this project has been engaged on a medium term basis to assist with the geology and grade control activities at Lerala.

KDL is currently in discussions with our Tilwane Joint Venture partners to explore the possibility of extending the early 2017 deadline for the drilling programme, given the current focus on Lerala. The terms for an extension were under consideration at the end of the quarter but no resolution has been made as yet. While there is no guarantee that these discussions will be successful, KDL will keep the market informed as the negotiation progresses.

4.2 METALS EXPLORATION ACTIVITIES

4.2.1 LOMERO-POYATOS GOLD-COPPER-ZINC PROJECT, SPAIN

The Lomero-Poyatos gold-silver-copper-zinc project (**Lomero**) is located 60km north of the deep-water port of Huelva in Andalucia, Spain, within Spain's premier mineral district, the Iberian Pyrite Belt. Lomero is a 1km-long tabular volcanogenic massive sulphide (VMS) deposit with elevated gold content. Previous mining operations extracted at least 2.6 million tonnes of massive sulphide ore containing an average grade of 5 g/t gold and 1.2% copper. KDL is evaluating the potential for a profitable re-development of Lomero through its wholly owned Spanish subsidiary, Alto Minerals S.L.

On 17 August 2016, subsequent to year end, the Company announced that it has entered into a farm in and joint venture arrangement with ASX listed Winmar Resources Limited (**Winmar**) in relation to the Lomero project. On January 25th, Winmar was granted approval to begin its inaugural drilling campaign at the Lomero programme. Drilling is scheduled to begin immediately.

4.2.2 YEOVAL COPPER-GOLD PROJECT, CENTRAL NSW (Zodiac, 75%)

On 1 September 2016, Zodiac Resources Pty Ltd entered into an agreement with Augur Resources Limited to terminate the farm in and joint venture agreement between those parties in relation to the Yeoval tenements. The parties agreed to relinquish and cancel the Yeoval tenements. KDL has a 58% shareholding in Zodiac Resources, which has a 75% interest in the project. The process of cancelling the tenement was ongoing as at 31 December 2016 with respect to ML811. EL6311 cancellation was finalised this quarter.

5 TENEMENTS

Tenement Interests disposed of by KDL (or in process of disposal)

PROJECT	TENEMENT
Yeoval Joint venture* NSW, Australia (Zodiac Resources has a 75% interest)	EL6311, ML811

- *Yeoval tenements relinquished during Quarter by agreement with joint venture partner. Cancellation of Yeoval tenements with relevant mining department is in progress as at end of Quarter for ML811 and finalised during this quarter for EL6311.

Tenement Interests retained by KDL

PROJECT	TENEMENT
Lerala Diamond Mine Central District, Botswana	2006/29L
Tenby Property Joint Venture North West Territories, Canada (20% interest after production decision)	3768, 3769, 4138, 4139, 4140, 4142, 4141, 4143, 3760, 3761, 3762, 4097, 4098, 4099, 4100, 4101, 4102, 4103, 4174, 4175, 4176, 4181, 4182, 4183, 4184, 4185, 4186, 4187, 4270, 4269, 4271, 4104, 4105, 4106, 4107, 4108, 4109, 4110, 4432, 4433, 4434, 4234, 4235
Commonwealth Property Joint Venture North West Territories, Canada (10% interest after production decision)	3763, 3764, 3765, 3766, 4144, 4145, 4111, 4112, 4113, 3770, 3719, 3771, 4114, 3772, 4115, 3773, 4116, 4117, 4118, 4119, 4120, 4121, 4122, 4123, 4124, 4125, 4126, 4127, 4128, 4129, 4130, 4437, 4438, 4439, 4435, 4272, 4177, 4440, 4436, 4441, 4178, 4328, 4442, 4266, 4325, 4267, 4326, 4327, 4268
Trillion Project Ontario, Canada	3013665, 3013666
Tilwane Joint Venture Central District, Botswana (50% interest)	PL267/2013, PL268/2013
Lomero Andalucía, Spain	IP14977, IP14978, IP14989

PL 267/2013 & PL 268/2013: KDL, via its wholly owned subsidiary Lerala Diamond Mines Limited, has the exclusive right to earn up to 70% in the project from Tilwane Services (Pty) Limited.

Tenby Property: Mantle Diamonds Limited, a wholly owned subsidiary of KDL, will acquire a 20% interest in the tenements upon a production decision by the registered owner, Diavik Diamond Mines Incorporated.

Commonwealth Property: Mantle Diamonds Limited, a wholly owned subsidiary of KDL, will acquire a 10% interest in the tenements upon a production decision by the registered owner, Diavik Diamond Mines Incorporated.

Lomero: IP (Investigation Permit) 14977 was formally granted to KDL on 13 May 2016. IP 14978 and 14989 are applications with priority assigned to KDL.

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APPENDICES

COMPETENT PERSON STATEMENTS

The information in this report that relates to Mineral Resources and Ore Reserves at the Lerala Diamond Mine is extracted from the report titled "Statement of Mineral Resources and Ore Reserves as at 31 December 2015", created on 11 January 2016 and available to view on www.asx.com.au and www.kdl.com.au. The company confirms that it is not aware of any new information or data that materially affects the information included in the original market announcement and that all material assumptions and technical parameters underpinning the estimates in relevant market announcement continue to apply and have not materially changed. The company confirms that the form and context in which the Competent Person's findings are presented have not been materially modified from the original market announcement.