GEM DIAMONDS

Annual Report 2012

Financial and operational performance

Financial performance

Revenue
US$202 million

Underlying EBITDA
US$66 million

Attributable net profit (before exceptional items)
US$17 million

Basic EPS (before exceptional items)
US$0.12

Cash on hand as at 31 December 2012 (net after debt)
US$68 million

(US$63 million attributable to Gem Diamonds)

Operational highlights

Letšeng
- Record carat production of 114 350 carats, up 2% from 2011
- Recovered grade 1.75 cpht, up 6% from 2011
- Waste tonnes moved 17.4m tonnes, up 27% from 2011
- Letšeng achieved a 4 Star rating in external SHE audit

Ellendale
- Carat production 155 996cts, up 30% from 2011
- Tonnes ore mined 4.67m tonnes, up 71% from 2011
- Tonnes treated 4.17m tonnes, up 34% from 2011
- Ellendale achieved 32 months LTI-free in May 2012, remaining fatality free since acquisition
- Ellendale retained its 4 Star rating in external SHE audit

Front cover: 11 carat blue diamond which sold in September 2012 for US$2.17 million (US$186 943 per carat)

Focus on value creation
Introduction

Gem Diamonds is a leading global producer of high value diamonds. The Company currently owns the Letšeng mine in Lesotho and is developing the Ghaghoo mine in Botswana, having disposed of the Ellendale mine in Australia during 2012. The Letšeng mine is renowned for its production of large, top colour, exceptional white diamonds, making it the highest average dollar per carat kimberlite diamond mine in the world. Letšeng has the distinction of having produced four of the 20 largest white gem quality diamonds ever recorded, since Gem Diamonds acquired the mine in 2006.

Gem Diamonds has an organic growth strategy based on the optimisation of its current operating Letšeng mine and the development of the Ghaghoo mine, expected to be in production during 2014. The Company also seeks to maximise revenue and margins from its rough diamond production by pursuing diamond manufacturing and sales and marketing initiatives further along the diamond value chain. With favourable supply/demand dynamics expected to benefit the industry over the medium to long term, particularly at the high-end of the market supplied by Gem Diamonds, this strategy positions the Company strongly to generate attractive returns for shareholders well into the future.

For further detail on our business please visit:
www.gemdiamonds.com

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Gem Diamonds at a glance

Our strategy is based on the on-going optimisation and further development of our existing assets in order to maximise the value of our mines. We also seek to maximise revenues achieved and to gain access to additional margins from our rough diamond production by pursuing sales and manufacturing initiatives further along the diamond value chain.

Gem Diamonds Ltd

Mines

Letšeng Diamonds

The Kingdom of Lesotho

Ownership:

70%

Gem Diamonds Limited

Acquired: July 2006

30%

Government of the Kingdom of Lesotho

Main operation:

Letšeng diamond mine – mining and processing diamond bearing ore sourced from the Main and Satellite kimberlite pipes

Famous for:

Producing large, top colour, exceptional white diamonds, making Letšeng the highest average dollar per carat kimberlite diamond mine in the world; since Gem Diamonds acquisition of Letšeng, the recovery of four of the 20 largest white gem quality diamonds ever recorded

Total resource:

4.0 million carats
(as at 1 January 2012)

In-situ value:

US$11.39 billion
(as at 1 January 2012)

Strategic objectives:

- Optimisation of Project Kholo at Letšeng, simultaneously improving diamond liberation and reducing diamond breakage
- To sustain Letšeng's position as the world's top producer of large, high-end diamonds
- To gain additional margin for Letšeng's production through 'smart sales'
- To cut and polish high margin diamonds to capture additional revenue

Highlights 2012:

- Carats recovered: 114 350
- Average US$ per carat: US$1 932
- Tonnes treated: 6.6 million
- Waste tonnes mined: 17.4 million

Sustainability performance:

- LTIFR 0.11
- AIFR 2.36
- Zero major environmental incidents recorded in 2012
- On schedule execution of Corporate Social Investment projects
- Letšeng achieved a 4 Star rating in the annual external SHE audit
- Regrettably Letšeng recorded one fatality in the year

FOCUS FOR 2013:

- Optimisation of Project Kholo to maximise return and minimise capex

Kimberley Diamond Company NL

Western Australia

Ownership:

Acquired: December 2007

DISPOSED OF

to Goodrich Resources Limited

Main operation:

Ellendale diamond mine – mining and processing diamond bearing ore sourced from the E9 lamproite pipe

Famous for:

Its rare fancy yellow diamonds, making it the most significant producer of these diamonds globally

Disposal of the operation:

- Disposed of Ellendale to ASX listed company Goodrich Resources Limited for a total cash consideration of US$15.4 million (including the repayment of a US$11.5 million loan)
- The Ellendale operation's short remaining life of mine and marginal returns at current diamond prices resulted in the operation ceasing to fit with Gem Diamonds' requirements for value return. Its disposal enables Gem Diamonds to refocus its resources and management time on those core assets that the management believes offer the most potential to deliver substantial returns to shareholders

Highlights 2012:

- Carats recovered: 155 996
- Average US$ per carat: US$720
- Tonnes treated per annum: 4.2 million
- Waste tonnes mined per annum: 6.5 million

Sustainability performance:

- LTIFR 0.51
- AIFR 11.64
- Achieved 32 months LTI free in May 2012
- Zero major environmental incidents
- Ellendale retained its 4 Star rating in the annual external SHE audit
- Fatality free since the operation commenced in 2002
- Indigenous Land Use Agreement with the Bunuba People was completed in 2012 and US$1.9 million was paid into the Bunuba People's Trust in early 2013

Gem Diamonds Botswana

Botswana

Ownership: **Acquired:** May 2007

100%

Gem Diamonds Limited

Main operation:

Development of the Ghaghoo diamond mine

Total resource:

20.5 million carats
(as at 1 January 2012)

In-situ value:

US$5.3 billion
(as at 1 January 2012)

Strategic objectives:

- Optimise the returns from Ghaghoo following the completion of Phase 1 development

Development highlights 2012:

- Phase 1 construction of the sand portion of the access decline 40% complete
- Phase 1 construction of the processing plant substantially complete

Sustainability performance:

- LTIFR 1.09
- AIFR 7.93
- HSSE system continues to be expanded at Ghaghoo
- Zero major or significant environmental incidents
- Community water supply programme continues with two communities now having sustainable water supply within the Central Kalahari Game Reserve
- 30% of Ghaghoo employees were recruited from the project affected communities
- Ghaghoo achieved a 4 Star rating in the annual external SHE audit
- Regrettably, Ghaghoo recorded two fatalities in the year

FOCUS FOR 2013:

- Continue to develop the underground mine
- Refine options for expanded mining, post Phase 1

Sales and marketing

Gem Diamonds Marketing Services BVBA

Belgium, Antwerp

Ownership:

100%

Gem Diamonds Limited

Formed: October 2010

Main operation:

- Diamond sorting, valuation and marketing service
- Diamond manufacturing advisory service

Strategic objectives:

- To maximise the value achieved on rough and polished diamond sales
- To develop the Group's Letšeng Diamond brand in marketing channels beyond the mine gate
- To identify key strategic areas for targeted revenue growth further down the diamond pipeline
- To increase customer base and quality
- To maintain strong relations with customers

Output highlights 2012:

- US$208 million sales from Letšeng production
- Extracted and/or partnered on the manufacturing of rough diamonds to the value of US$32 million
- Cemented existing and commenced new manufacturing partnerships
- Increased diamond sales channels
- Established marketing presence

Sustainability performance:

- Gem Diamonds continues to adhere to the provisions of the Kimberley Process and all its diamonds are certified in terms of the Kimberley Process certification scheme and all its polished diamonds are certified by the Gemological Institute of America (GIA)
- Gem Diamonds registered as a candidate organisation with the Responsible Jewellery Council, with full registration expected to be concluded in 2014

FOCUS FOR 2013:

- Continue to achieve top prices for all goods sold
- Continue to explore brand development opportunities and markets closer to the consumer
- Optimise sales activities
- Investigate diamond sales opportunities in new jurisdictions

Manufacturing

Owned technology and intellectual property

Antwerp, Lesotho, Mauritius and South Africa

Commenced:

September 2008

Main operations:

- Owned: Antwerp, Lesotho, Mauritius, South Africa

Strategic objectives:

- Provide manufacturing capacity, either in-house or outsourced, to meet the Group's current manufacturing requirement and growth objective
- Produce high-end polished diamonds, primarily sourced from the Group's mining operations
- Continue to source, develop and/or establish state of the art technology and grow intellectual knowledge in the Group's manufacturing operations

Output highlights 2012:

- Established facility and sourced significant intellectual knowledge for high-end diamond analytical and manufacturing operations in Antwerp
- Provided key valuation data to the Group's marketing arm to optimise marketing channels for rough and polished diamonds
- Deployed the Calibrated laser cutting technology in Mauritius
- Broke ground in Maseru, Lesotho, where a new manufacturing facility is to be established in line with the objective to establish in-country manufacturing capability
- Enhanced relationship with clients and partners through experience gained in analysis and manufacturing

Sustainability performance:

- Gem Diamonds continues to adhere to the provisions of the Kimberley Process and all its diamonds are certified in terms of the Kimberley Process certification scheme and all its polished diamonds are certified by the Gemological Institute of America (GIA)
- Gem Diamonds registered as a candidate organisation with the Responsible Jewellery Council, with full registration expected to be concluded in 2014

FOCUS FOR 2013:

- Increase volumes through the Group's established facilities
- Complete establishment of facilities in Mauritius and Lesotho and bring into production
- Optimise deployment of technology and expertise in Group facilities for different types and qualities of production – Antwerp: lower volume, large diamonds and in Mauritius and Lesotho: higher volume, smaller diamonds

Our business model

How we do business across the diamond value chain

Gem Diamonds' business model focuses primarily on extracting diamonds through the mining of our mineral resources at our operating assets. Increasingly, the company has expanded its focus further along the diamond value chain through strategic sales and marketing, and value added manufacturing activities in order to access additional 'post mine gate' revenues.

The Company is committed to sustainable development which underpins our desire to maximise value for shareholders and society. Fundamentally this helps secure our licence to operate, aids in risk management, reduces operating costs, and enhances our reputation, which in turn drives customer attraction.

Develop

What we do

- Invest capital to develop diamond producing mines at our mining leases.

See pages 18-29 for more detail

Optimise and produce

What we do

- Mine economically viable diamond deposits on our mining leases.
- Undertake long-term mine planning to ensure optimal resource usage.
- Optimise operating efficiencies across the mining cycle: drilling, blasting, loading and hauling, crushing, screening and concentration, separation, sorting and recovery.
- Maximise cost efficiencies across the mining process.
- Ensure safe operation and minimise all impacts across the mining cycle.

See pages 18-31 for more detail

Sales and marketing

What we do

- Maximise the value achieved for our diamonds and employ various strategies to access additional "post mine gate" revenue.

Rough sales strategy:

- Utilise multiple marketing methodologies to sell our rough diamonds – tender, auction, off-take arrangements.

Polished sales strategy:

- Own manufacture and sales of our select high value rough diamonds.
- Strategic partnering on the manufacture and sale of our exceptional, high value diamonds.

See page 30 for more detail

Valuation and manufacturing

What we do

- Analyse and map exceptional diamonds.
- Manufacture select diamonds.
- Increase our in-house manufacturing intelligence.
- Develop our manufacturing capacity to meet the Group's growth plans.

See page 30 for more detail


478 carat Light of Letšeng, recovered at Letšeng in September 2008

Chairman's statement

Record carat production and refocusing of strategy to generate greater returns for shareholders

Introduction

2012 was underpinned by an excellent operational performance and record carat production for Gem Diamonds, as the Company worked to maximise value from its portfolio of assets. The Company's flagship Letšeng mine delivered its second successive record carat performance in 2012, by producing 114 350 carats (compared to the previous record in 2011 with 112 367 carats produced). The Ellendale mine achieved a 30% increase in carats recovered to 155 996 carats. Gem Diamonds strives for zero harm at each of its operations and regretfully, in spite of a year of strong operational performance, we have to report three fatalities for the year – one at Letšeng and two at Ghaghoo. The Board and management of the Company offer their sincere condolences to the families of the deceased employees.

In keeping with the Company's stated strategy for focused delivery of value through the enhancement of key assets, the Company's asset base has been restructured through the disposal of those projects which did not meet the requirements for value return. This consolidation and optimisation of the Company's asset portfolio has enabled the Company to refocus its resources and management time on those core assets that the Company believes offer the most potential to deliver substantial returns to shareholders. The disposal of 100% interest in its wholly owned subsidiary, Kimberley Diamond Company NL in Australia was concluded during the year and the transaction was duly completed on 31 January 2013. In addition, the Company's participation in the Chiri project in Angola terminated in November 2012.

"In keeping with the Company's stated strategy for focused delivery of value through the enhancement of key assets, the Company's asset base has been restructured through the disposal of those projects which did not meet the requirements for value return. This consolidation and optimisation of the Company's asset portfolio has enabled the Company to refocus its resources and management time on those core assets that the Company believes offer the most potential to deliver substantial returns to shareholders."

The sharp fall in diamond prices, which had commenced in the third quarter of 2011, continued to be felt throughout 2012 as the Eurozone crisis and global financial uncertainty persisted. As a result, the prices realised for the Company's Letšeng diamonds were approximately 15% lower in 2012 than for the previous year, with even sharper falls experienced in some categories of rough goods in the market. This contributed to a decline in the Group's revenues (excluding Kimberley Diamond Company) in 2012 to US$202.1 million and the underlying EBITDA falling to US$65.5 million, down from the record profit achieved in 2011.

As a result of the impact of weaker diamond prices on revenues and cash flows during the year, the Company acted swiftly to scale back the capex earmarked for Project Kholo and for the development of Phase 1 at the Ghaghoo mine. Accordingly, at Letšeng, those elements of Project Kholo which are more capital efficient and offer near-term returns, have continued to be implemented. For example, work is already underway to replace four crushing units in both of Letšeng's existing processing plants with crushers designed for project Kholo, with the aim of reducing diamond damage and thus minimising the loss of revenues. These crushers will be installed by June 2013. Effective delivery and implementation of these key workstreams should provide a stronger operating platform for the Company, enabling Gem Diamonds to expand carat production and significantly enhance profit margins, even in the current uncertain economic environment, and to increase the positive effect of any strengthening in diamond prices. This should enable Gem Diamonds to emerge a far stronger, leaner and more focused company in 2013, capable of capturing better value in the diamond market and to be well placed to extract value from its assets for shareholders.

Diamond market

2012 was a volatile and challenging year for the diamond industry. The Eurozone crisis, reduced liquidity from the lending banks, high stock levels in the manufacturing sector and low demand from the emerging markets in the East resulted in downward pressure on diamond prices in 2012.

Following the more than 30% correction in rough diamond prices experienced after September 2011 the year started positively for rough diamond prices, with prices for rough diamonds increasing by approximately 6% to May 2012. However, from May 2012 through to August 2012, trading conditions were again extremely challenging. The continued low levels of polished trading as a result of the slowing demand in the emerging markets of the East and the major US market, coupled with sustained high levels of rough supply into the market by the major producers, resulted in an overstocking of both rough and polished in the manufacturing sector. This overstocked situation and the tightening of liquidity by the lending banks saw demand for rough diamonds reducing considerably and rough diamond prices decreased by approximately 20% from June to August 2012. After August, polished trading began to improve, with a resulting increase in demand for rough diamonds.

In the longer term, the prospect for diamonds remains excellent. Rough diamond production is unlikely to reach previous peaks and, with growing Asian consumer demand for diamond jewellery supporting the improving major US market, demand for rough and polished diamonds should begin to outpace supply, sustaining a longer term price growth trend.

Operational overview

Operationally, Gem Diamonds has had a strong year, with Letšeng delivering its second successive record in terms of carats produced. This was largely driven by an increase in Letšeng's recovered grade as a result of mining in the higher grade K6 facies in the Main pipe. 114 350 carats were produced in 2012 which was an improvement on the record performance of 112 367 carats in 2011. This record was achieved despite two very heavy snowfalls during the winter of 2012 which caused the loss of four days of production. Great credit must go to management and the Letšeng technical team for this successive record achievement.

As previously communicated, in light of the challenging global economic climate, the Board took the decision to focus on greater capital discipline and to preserve balance sheet strength. This has seen a refocusing and scaling back of capital expenditure on Project Kholo at Letšeng, in order to focus on those components of Project Kholo which were value accretive but less capital intense. By way of example, installing four new crushing units on plants one and two, as envisaged by the initial Project Kholo plans, in order to reduce the adverse effects of the older crushers on diamond damage. This work will be completed by mid-2013.

The exploration drilling programme at Letšeng was completed during 2012 and has resulted in very encouraging results which have confirmed and extended the resource in both pipes and which will be included in an updated resource model to be completed shortly.

Chairman's Statement continued

The focus for 2013 will be on implementing and delivering value accretive workstreams at Letšeng, focused on enhancing revenue generation and improving margins through the reduction of diamond damage and by an effective cost reduction programme aimed at optimising treatment and mining unit costs. The upgrading of the existing mining fleet, in order to meet future production requirements, will continue. The Company will continue to assess opportunities to upgrade technology within its operations to improve efficiencies, safety and enhance profitability.

At Ghaghoo, the development of Phase 1 of the underground project has continued as planned. The camp and surface infrastructure is complete and the plant has been installed on schedule. The access decline is proceeding well, albeit at a slower rate than originally planned due to encountering unforeseen ground conditions. It is anticipated that the first kimberlite will be processed through the plant in the second half of 2014.

Health and safety

The Company continues to strive towards setting the highest standards of health and safety across the Group's operations and the highest priority is given to ensuring the health and safety of our employees in the workplace. In furtherance of this goal, a number of key managers attended a course on health and safety run by Du Pont in the USA and on site in the Company's technical offices. Although there was a good deal of learning and interaction, it was also satisfying to note that management had already been performing at a very high level in this key area.

During 2012 Letšeng achieved a creditable 13 consecutive months without a Lost Time Injury. However, in December 2012, a non-mining fatality occurred at Letšeng when a casual employee was fatally injured by a wall which collapsed onto her. The Board and management of the Company once again offer our sincere condolences to the family of the deceased employee.

At Ghaghoo, a sound safety record was marred by the tragic collapse of sand in the access decline in which two contractor employees lost their lives. After a full investigation, remedial steps were taken to prevent any such similar occurrence. The Board and management of the Company again extend their heartfelt condolences to the families of the deceased employees.

Stakeholder relationships and environmental

The Company places great emphasis on its relations with the governments and communities in the areas in which it operates.

In Lesotho, a number of community projects were completed and new ones initiated. A third woolshed was opened in October 2012 at Libibing in the Mokhotlong district, close to where the Letšeng mine is situated. These woolsheds have made a dramatic impact upon the livelihood of the wool and mohair farmers in this impoverished district, who are now able to shear and bale wool in modern sheds with access to electricity and transport routes to ports in South Africa. It is pleasing that the Minister of Agriculture made a congratulatory speech at the opening of the third woolshed and this highlights the sound relationship which is enjoyed with government and the Project Affected Communities.

The Letšeng scholarship programme is well regarded throughout Lesotho and continues to subsidise the education of Lesotho born students at local and regional universities and technikons, followed in many cases by an internship on the Letšeng mine and eventual employment there. In 2012 a new project, working in partnership with government, was initiated by the Company to establish a mountain search and rescue facility in the Lesotho highlands in order to encourage tourism and reduce the number of fatalities from adverse weather conditions experienced during the severe winter weather. In March of this year, the first trainees will be sent to Scotland to attend a practical training course run by the Scottish mountain search and rescue facility in the Scottish Highlands.

In Botswana, 2012 saw the installation of borehole water points in the Central Kalahari Game Reserve where the local Basarwa communities are now able to access water. The community which is situated close to the Ghaghoo mine has water piped to their village and have received emergency medical attention from the medical station at the Ghaghoo mine. Almost 150 members of the community have been employed at the mine in either permanent or temporary capacities. The positive interaction with the project affected communities is on-going and is coordinated by a community liaison officer at the mine.

At Ellendale, a community needs analysis was conducted during late 2011 in order to improve the appropriateness and sustainability of the Company's CSI investments in Australia and the Bunuba People's Trust was created. During 2012, the Company paid US$1.9 million in lieu of share options into this community trust. These funds are now available for community motivated projects to be undertaken.

There have been no major environmental incidents at any of the Company's operations during the period and further details of the Company's commitment to the environment is to be found in the Sustainability section of this report or in the 2012 Sustainable Development Report available on the Gem Diamonds website, www.gemdiamonds.com

Strategic focus

Further to the review of the Company's assets communicated to shareholders in 2011, management has implemented the stringent process of disposing of those assets which do not meet the criteria of generating shareholder returns. Accordingly, the Ellendale mine in Australia was disposed of to Goodrich Resources for a cash consideration of US$15.4 million. This disposal was made taking into consideration the relatively short remaining mine life and a potentially substantial environmental liability upon closure.

In addition, the Company terminated its involvement in the Chiri project in Angola once it had become clear that the development of this deposit, on the terms available to it, would not meet the stringent financial returns requirements set by the Company review.

The Company has implemented measures to reduce cost overheads in line with the strategic focus on its remaining core assets.

Despite a difficult 2012 for the diamond mining sector, the Company is now well positioned to focus upon the key mining and development assets of Letšeng and Ghaghoo as well as its successful sales and marketing division which, it is anticipated, will maximise shareholder returns over the coming years. Set against the slowly recovering global economy and the emerging constrained supply in the rough diamond market, I am confident that the Company is very well placed to take advantage of a recovery in the diamond mining industry.

Roger Davis
non-Executive Chairman

11 March 2013

Our strategy

Our business is run around three core business objectives:

1. Growth

Organic growth:
Expansion of our world class Letšeng mine and development of Ghaghoo mine, using available capital to deliver optimum returns to shareholders.

Value accretive opportunities:
Additional value generation with expanded sales and marketing capabilities incorporating manufacturing and downstream initiatives.

See pages 18-31 for more detail

2. Value creation

Operational excellence:
Focus on cost reductions and enhancing our current production efficiency.

Optimising returns:
Improve quality of our assets through life of mine extensions. Improve the capital structure. Improve revenue achieved for our diamond production through the reduction in breakage and theft.

See pages 18-31 for more detail

3. Sustainability

Stakeholders and communities:
Build long-term, transparent and mutually beneficial relationships with all stakeholder groups.

Health, safety and environment:
Sustainably achieve zero harm.
Ensure mitigation of impacts upon the receiving environment.

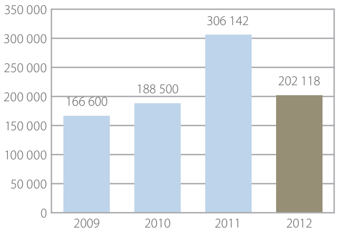
See pages 40-47 for more detail


"Phase 1 development of the Ghaghoo mine continues unabated, although progress in the sand portion of the access decline was slower than anticipated due to unforeseen adverse ground conditions during the year. Ground level infrastructure is complete, with the processing plant over 90% installed. It is anticipated that the first ore will be put through the processing plant around mid-2014."
For further detail please visit:
www.gemdiamonds.com

Key performance indicators

1. Growth

Revenue (US$'000)



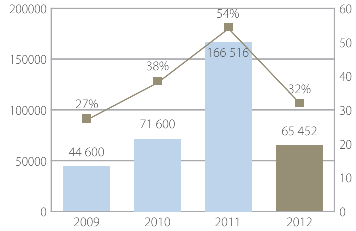
Description

Revenue represents the value of goods sold during the year and measures the level of operating activity and growth of the business. Revenue for the year is as reported in the Consolidated Income Statement.

Commentary

The decrease in revenue of 34% is driven by decreased diamond prices achieved at Letšeng.

Underlying EBITDA (US$'000) / **Underlying EBITDA margin** (%)



Description

Underlying EBITDA means earnings before interest, tax, depreciation and amortisation. It is also adjusted for share-based payments, other income, foreign exchange differences and exceptional items.

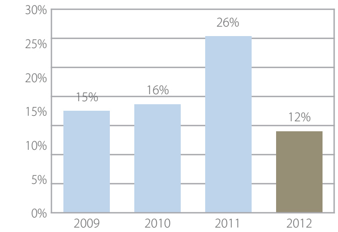
Underlying EBITDA margin is calculated as underlying EBITDA as a percentage of revenue.

Both these indicators provide a measure of the operating profitability of the business. Refer to Note 3, Operating profit in the financial statements for the calculation of underlying EBITDA.

Commentary

The underlying EBITDA result (down 60% year-on-year) reflects the weaker diamond prices, as cost management and operational efficiency focus continued.

Return on Capital Employed (ROCE) (%)



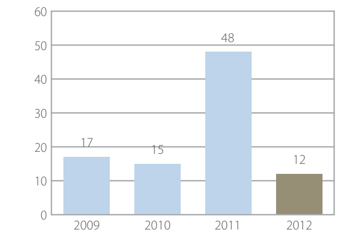
Description

ROCE is a post tax measure of the efficiency with which the Group generates operating profits from its capital. ROCE is calculated as underlying EBITDA (as per Note 3, Operating profit, in the financial statements) less depreciation and tax divided by average capital employed (being total equity and non-current liabilities per the consolidated balance sheet).

Commentary

Post tax ROCE achieved 12%, driven by lower diamond prices which negatively impacted earnings.

Basic Earnings per Share (continuing operations) (EPS) (US cents)



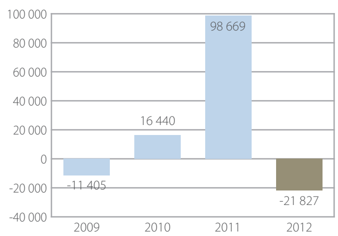
Description

Basic EPS represents net profit attributable to equity shareholders on continuing operations and is stated before exceptional items and after taking into account non-controlling interest. This is a measure of net profitability of the Group taking into account changes in the equity structure. EPS is calculated as reported in the Consolidated Income Statement and in accordance with Note 10, Earnings per share in the financial statements.

Commentary

Basic EPS (continuing operations) at 12 US cents per share is indicative of the lower earnings achieved as a consequence of the lower diamond prices achieved.

Free Cash Generated (US$'000)



Description

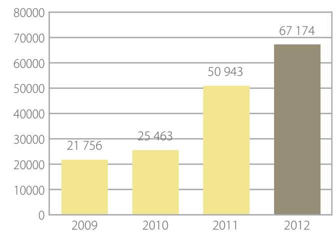
Free cash generated represents net cashflows before financing activities and investing activities in expansion projects. This measures the cash generating capability of the Group to fund future growth. Free cash generated is reflected in the statement of cashflows and is determined by cashflows from operating activities less sustaining capital of US$21.2 million (pre expansion capital) and less waste cash costs capitalised as reflected in the footnote to Note 11, Property, plant and equipment in the financial statements. The effect of Kimberley Diamonds Company NL during the year has been included in this graph.

Commentary

The Group utilised existing cash resources and cash flows from operations to fund existing capital commitments and operating costs. As a result of the impact of weaker diamond prices on revenues and cash flows during the year, capital expenditure earmarked for Project Kholo and for the development of Phase 1 at the Ghaghoo mine was scaled back.

2. Value creation

Capital Expenditure – including future growth projects (US$'000)



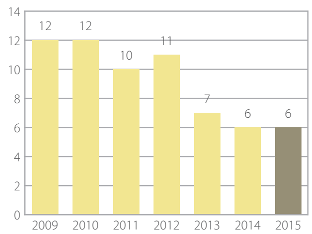
Description

Capital expenditure represents the amount invested in the Group's organic growth plans. Capital expenditure is reflected in the statement of cashflows and is determined by purchases of property, plant and equipment, (both expansion and sustaining capital) excluding waste cash costs capitalised as reflected in the footnote to Note 11, Property, plant and equipment in the financial statements. The effect of Kimberley Diamonds Company NL during the year has been included in this graph.

Commentary

The Group invested US$21.2 million in sustaining capital expenditure during 2012 to optimise and improve operational performance and invested US$47 million in expansion capital, the majority of which was attributable to the continued development of Ghaghoo.

Production Tonnes Treated – including future growth projects (millions)



Description

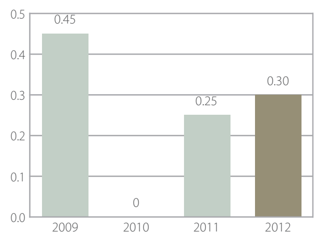
The production profile sets out the tonnes treated by the Group. The production tonnes treated at the Ellendale mine at Kimberley Diamonds Company NL during the year have been included in this graph.

Commentary

The increase in the production volumes in 2012 was driven by increased tonnes at Ellendale as a result of a number of modifications to the treatment plant that were completed towards the end of 2011. The future production profile reflects production at Letšeng (excluding any increase in production that would result from the implementation of Project Kholo) and the commencement of production from Ghaghoo in mid-2014.

3. Sustainability

Lost Time Injury Frequency Rates (LTIFR)



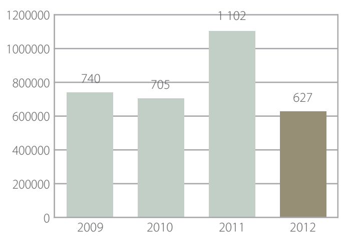
Description

The LTIFR provides a measure of the safety performance of the Group, including partners and contractors. LTIFR is measured on the basis of reported LTI statistics for all of Gem Diamonds' companies and subcontractors, expressed as a frequency rate per 200 000 man-hours.

Commentary

The LTIFR for the year was 0.30 and was the result of eight LTIs recorded for the Group. This included one LTI and one fatal injury at Letšeng, two LTIs at Ellendale and two LTIs and two fatal injuries at Ghaghoo. The Group drives to continually improve its safety record and its target for LTIFR is zero.

Corporate Social Investment Expenditure (US$'000)

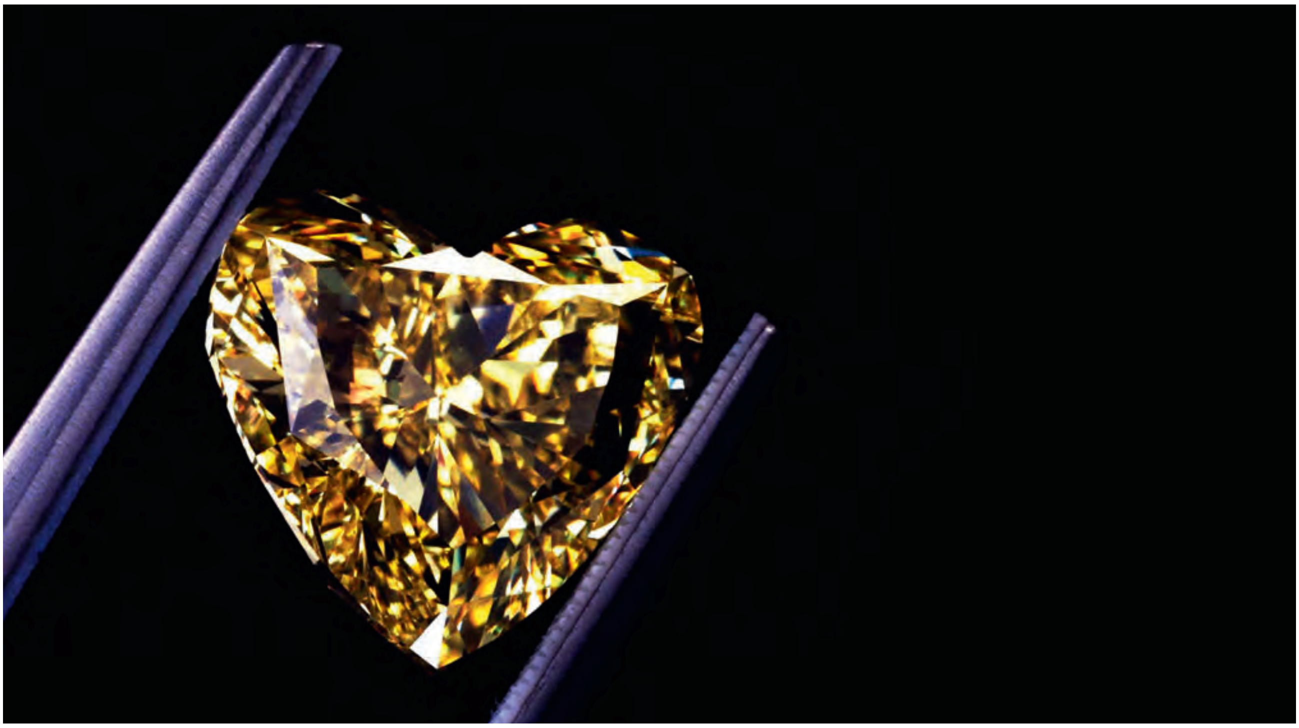


Stakeholders, communities and environmental

The Group has continued its commitment to Corporate Social Investment and environmental management. This has resulted in US$0.6 million invested in community related projects during the year and the continuation of mutually beneficial and transparent relationships with our Project Affected Communities. There were no major environmental incidents recorded during the year.

Kimberley Diamonds Company NL was disposed of in the current year and has been reflected as a discontinued operation. Hence the key performance indicators above exclude the impact of Kimberley Diamonds Company NL for the current and all prior year comparatives unless otherwise stated.

Our marketplace



Global rough price devaluation for full year 2012

-15%

Source WWW Forecasts Ltd

The global diamond market

2012 was a volatile and challenging year for the diamond industry. The Eurozone crisis, reduced liquidity from the lending banks, high stock levels in the manufacturing sector and low demand from the emerging markets in the East resulted in downward pressure on diamond prices in 2012.

Following the more than 30% correction in rough diamond prices experienced in September 2011 also as a result of the factors mentioned above, 2012 started positively for rough diamond prices, with prices for rough diamonds increasing by approximately 6% to May 2012. However, from May 2012 through to August 2012, trading conditions were extremely challenging.

The continued low levels of polished trading as a result of the slowing demand in the emerging markets of the East and the major US market coupled with sustained high levels of rough diamond supply into the market by the major producers resulted in an overstocking of both rough and polished diamonds in the manufacturing sector. This overstocked situation and the tightening of liquidity by the lending banks saw demand for rough diamonds reducing considerably, with rough diamond prices decreasing by approximately 20% from June to August 2012. Prices for higher value diamonds were also impacted.

Post August 2012, as the year drew to an end, polished diamond trading began to improve and demand for rough diamonds increased as a result. Demand for both rough and polished diamonds improved as the downward trend in polished diamond prices stemmed and the new rough diamond prices saw margins return to the manufacturing sector, although not to a significant extent. Furthermore, reasonable year-end diamond jewellery sales in the major US market and the expected lower future rough diamond supply from one of the major producers saw rough diamond demand and prices improve in the last quarter of 2012.

According to WWW Forecasts Ltd, global average rough diamond prices for the year finished approximately 15% lower than at the start of the year.

While rough prices saw positive growth in the first five months of 2012, the low levels of trading and resultant high inventory levels in the polishing sector saw the trend in polished prices fall for the whole of 2012. However, as with rough prices and for the reasons stated above, polished diamond prices found a more stable level towards the end of 2012 as trading levels improved towards the year-end and in the months leading up to the Chinese New Year in February 2013. Positively, demand for the larger higher end diamonds is increasing and prices for these goods are starting to edge positively.

According to WWW Forecasts Ltd, average polished prices finished the year 11% below those seen at the start of the year.

Outlook for 2013

Although the factors that caused volatility in diamond prices during 2012 are likely to continue for some time, prices in the first half of 2013 are expected to be more stable, leading up to the Chinese New Year. In particular, Gem Diamonds has seen an improvement in rough demand and prices achieved at the two tenders conducted so far in 2013. This may signal a shift in sentiment within the diamond market, especially amidst fears of reducing supply.

In the longer term, the prospect for diamonds remains excellent. Rough diamond production is unlikely to reach the previous peaks – with limited new production coming on stream and with the growing Asian consumer demand for diamond jewellery reinforcing the improving major US market, demand for rough and polished diamonds should begin to outpace supply, sustaining a continued long term price growth trend.

Global polished prices devaluation for full year 2012

-11%

Source WWW Forecasts Ltd

Ellendale fancy yellow diamonds

550 carat Letšeng Star

Business review
Chief Executive Officer's overview

"Although 2012 was a challenging year for the diamond industry and for Gem Diamonds, it is pleasing to see that 2012 was a strong operational year for the Group, with a second successive record carat production at Letšeng, our flagship asset. Moreover, the disposal of underperforming assets will result in a more focused management team, confident of improving returns to shareholders in the coming years."

Introduction

Gem Diamonds has achieved record operational results during 2012 with a second successive record carat production year at Letšeng of 114 350 carats (versus 112 367 carats in 2011) and a significantly improved grade of 1.75 carats per hundred tonnes (cpht). This success has been mirrored by improved carat production at Ellendale and credit must go to the management teams at both the mines and at the Company's technical support office for these impressive operational achievements.

After a record financial year in 2011, the sharp fall in diamond prices which began in the third quarter of 2011 and again in 2012, led to the Company taking quick action to implement capital discipline at Letšeng and Ghaghoo in order to preserve the Company's strong balance sheet.

The on-going Eurozone crisis in 2012 and the persistent global financial uncertainty led to a fall of some 15% in rough diamond prices for equivalent Letšeng type goods over the year. This contributed to a decline in the Group's revenue to US$202.1 million and an underlying EBITDA of US$65.5 million for the year.

2012 was a key year for Gem Diamonds, which saw a consolidation of the Company's asset portfolio to strengthen the position of the Company going forward, as well as the continued implementation of the Company's strategic plan for the focused delivery of value to shareholders through the enhancement of key assets. Accordingly, a number of assets which did not meet the stringent requirements for value creation have been sold or terminated over the past two years. This year saw the conclusion of a sale agreement in respect of the Ellendale mine which was sold to Goodrich Resources for US$15.4 million, with the transaction having been completed at the end of January 2013.

Given the very short remaining life of mine, low margin operation and the significant environmental rehabilitation liability of Ellendale, the Board considered this to be in the best interests of shareholders and this disposal will allow management to focus on the remaining core assets of Letšeng and Ghaghoo.

In addition, the Company terminated its participation in the Chiri project in Angola when it became clear that the terms upon which on-going participation in this deposit could be secured, did not meet the requirements of the Company for value creation.

Sunset over Ghaghoo

Letšeng processing plant

Letšeng recovery plant

Project Kholo at Letšeng has been scaled back, however, strong progress has been made and with key work-streams on-going, it is pleasing to report that four new secondary crushers will be installed in Letšeng's existing processing plants by mid-2013. It is anticipated that these crushers will have a significant effect in reducing diamond breakage, thereby increasing average per carat values – an important component of Project Kholo.

The development of Phase 1 at Ghaghoo continues unabated and the camp and ground level infrastructure is complete, with the processing plant over 90% installed. Progress in the access decline has been slower than anticipated due to unforeseen adverse ground conditions and tunnel development has since been slow but steady. It is anticipated that the first ore will be put through the plant by mid-2014.

The implementation of the Company's sales and manufacturing strategy continued throughout 2012 and resulted in a number of diamonds which were either cut and polished by the Company itself at its facilities in Antwerp, or were manufactured in partnership arrangements with some of the world's leading diamantaires. Gem Diamonds' sales and manufacturing strategy continues to extract additional value from the diamond value chain for the Company and the Group is focused on further developing and enhancing this strategy to ensure increased exposure to value chain.

HSSE

Health and safety has been an area of continuing focus throughout the Group and it is pleasing to report that Letšeng achieved 13 months of zero Lost Time Injuries during 2012. This achievement was undermined by a tragic non-mining accident in December when a casual employee had a wall collapse upon her in the laundry courtyard. After being stabilised and receiving medical treatment at the mine clinic, the employee was transferred to the local hospital where she passed away the following day. At Ghaghoo, the adverse ground conditions encountered in the access decline resulted in the collapse of ground which tragically resulted in two fatalities in May 2012. Remedial action was taken after a full investigation was undertaken into the cause of both of these incidents. The Board and management again extend their sincere condolences to the families of the deceased employees.

Operational outlook

The outlook for the diamond industry is showing signs of an improvement, and the initial Letšeng tender for 2013 realised US$27.9 million for 16 188 carats – an encouraging result for production sourced entirely from the lower value Main pipe. Other rough diamond sellers are reporting similarly promising results at the outset of 2013. Moreover, the longer term prospects for the diamond mining industry remain excellent, with production well off the peaks and with rapid growth forecast in the Asian markets and continued improvement in the key US market, which is expected to outstrip supply, with no significant supply scheduled to come on-stream in the medium-term.

Clifford Elphick
Chief Executive Officer

11 March 2013

For further detail please visit:
www.gemdiamonds.com

Business review
Letšeng

The Letšeng mine is famous for its large, top quality diamonds and achieves the highest average dollar per carat of any kimberlite diamond mine in the world. Gem Diamonds owns 70% of Letšeng Diamonds (Letšeng) in partnership with the Government of the Kingdom of Lesotho, which owns the remaining 30%. Letšeng was acquired in July 2006 and has continued to deliver exceptional returns for its shareholders.

Since Gem Diamonds took control, Letšeng's annual production has risen from 55 000 carats in 2006 to 114 350 carats in 2012, with an investment programme in place focused on further expanding production going forward. During this period, it has produced four of the 20 largest white gem diamonds ever recovered: the 603 carat Lesotho Promise in 2006; the 493 carat Letšeng Legacy in 2007; the 478 carat Light of Letšeng in 2008; and the 550 carat Letšeng Star in 2011.

Diamond sales

	Year-ended 31 December 2012	Year-ended 31 December 2011
No. carats sold	**107 617**	107 700
Average US$ per carat	**1 932**	2 776

Frequency of recoveries of large diamonds at Letšeng

No of diamonds*	2008	2009	2010	2011	**2012**
>100 carats	7	5	6	5	**3**
60-100 carats	16	10	10	19	**13**
30-60 carats	74	76	61	59	**61**
20-30 carats	88	98	89	91	**110**
Total diamonds >20 carats	185	189	166	174	**187**

*Letšeng's treatment plants only, excludes Alluvial Ventures production

Operational highlights

- Carats recovered: 114 350
- Average US$ per carat: US$1 932
- Tonnes treated: 6.6 million
- Waste tonnes mined: 17.4 million

Sustainability performance

- LTIFR 0.11
- AIFR 2.36
- Zero major environmental incidents recorded in 2012
- On schedule execution of corporate social investment projects
- Letšeng achieved a 4 Star rating in the annual external SHE audit
- Regrettably Letšeng recorded 1 fatality in the year

Letšeng produced a record of 114 350 carats in 2012, mainly driven by a higher recovered grade as a result of mining entering the high grade Main pipe K6 facies for the first time during the year. This achievement increased Letšeng's recovered grade for the second year in succession to 1.75 cpht compared to 1.65 cpht in the prior year. Tonnes treated for the year were 6.6 million tonnes compared to 6.8 million tonnes in 2011. Heavy snowfalls caused two power outages in the recovery plants which lasted for a total of four days, due to the difficulty in repair crews accessing the site. Tonnes treated also reduced in December in order to allow the mine to investigate whether the plant feed rate may have any impact on diamond damage. Analysis of the results from this test is still on going. Of the total ore treated for the year, 72% was sourced from the Main pipe, 24% from the Satellite pipe and 4% from Main pipe stockpiles. Production for the year resulted in underlying EBITDA of US$91.0 million.

Waste tonnes moved in 2012 was 17.4 million tonnes, 27% higher than the prior year (based on the revised 2011 waste tonnes moved of 13.7 million tonnes). During the year three new CAT 777 trucks were brought to site joining the CAT 773's that were added to the mining fleet during 2010 and 2011. These new, larger units will add capacity to the waste stripping fleet as the stripping requirement begins to increase with the deepening of both the Main and Satellite pipes over time.

The quantification of the shortfall of waste tonnes mined compared to that reported (due to the issue with surveying techniques which was reported in the H1 2012 trading update) has been finalised. Reporting has been revised and mine plans for future years have taken full account of the shortfall. The updated planning and the current stripping capacity indicate that no problems are foreseen in ensuring the required future ore exposure.

In late 2012, after considering the existing and expected global economic outlook, the Board decided that Project Kholo should be scaled back with a focus towards a lower, more capital efficient project. A number of less capital intensive opportunities to add significant value at Letšeng have been identified. These are based around the upgrading of the current processing plants by installing the improved recovery technologies that had been planned for the new Project Kholo plant, as well as potentially increasing throughput capacity. Studies are underway to determine the most optimal plan and timing.

Work is already underway to replace four crushing units in the two existing processing plants, with crushers previously designed for Project Kholo. These crushers are expected to reduce diamond damage and the project is expected to be completed by mid-2013.

The resource drilling programme that was started in late 2011 was completed during the year. The objectives were to increase geological and geotechnical knowledge on the existing resource at Letšeng, as well as to define additional resources below the current limits. A total of 19 holes were drilled during the programme. In terms of the resource extension, approximately 230 metres of additional depth was delineated below the Satellite pipe and 320 metres below the Main pipe. This extends confirmation that the two pipes exist at 828 metres and 793 metres below surface respectively (current mining in both pipes is at approximately 160 metres below surface). An updated resource model is expected to be completed by the end of the first quarter in 2013 based on the results of the drilling campaign. More detail on this drilling programme is provided in the Mineral Resource section of the Annual Report.

Mining in Letšeng's Main pipe

Letšeng Plant 2

Business review
Letšeng continued

Letšeng continued to recover high value diamonds during the year, most notably the recovery of an 11 carat blue diamond which sold in September 2012 for US$2.17 million (US$186 943 per carat).

During the year a pre-feasibility study on converting the Satellite pipe to an underground operation prior to the completion of the planned open-pit was completed. The results indicate that commencing an underground operation sooner has a very similar value proposition compared to completing the current economic open-pit, and then continuing with underground mining. Studies on underground mining will continue however, and post the completion of the updated resource model mentioned above, the study will be revised, taking into account all relevant operational updates, including the revision to Project Kholo and the latest economic forecasts. Should the outcome indicate that the early-start underground option still shows potential, a full feasibility study will then commence.

Sales and marketing strategy

Letšeng's rough production is sold through Gem Diamonds Marketing Services BVBA (Gem Diamonds Marketing), an Antwerp-based wholly owned Gem Diamonds subsidiary. Letšeng has complete flexibility and control over the marketing of its rough production. A key element of Letšeng's marketing strategy has been to access additional margins by pursuing sales and manufacturing initiatives further down the diamond value chain.

Gem Diamonds Marketing generally holds ten tenders annually for the Letšeng rough production, two in each of the first and third quarters and three in each of the second and fourth quarters. In addition to the rough tenders, Gem Diamonds Marketing extracts select diamonds for manufacturing and sale as polished and/ or for sale into Letšeng's high-end manufacturing partnerships.

Diamond sales

The average value for Letšeng's rough diamond exports (including diamonds extracted for manufacture) of unique diamonds for the year was US$1 932 per carat, compared to the average price of US$2 776 per carat achieved in 2011, representing a decrease in the average price of 30%.

In 2012, 647 rough diamonds greater than 10.8 carats in size (+10.8 carats) compared to approximately 591 diamonds in 2011, were recovered at Letšeng, totalling 13 554 carats and contributing to 73% of total rough diamond value at Letšeng (14 104 carats, contributing 77% of Letšeng's revenue in 2011). A total of 134

Drilling in Letšeng's Main pipe

diamonds recorded prices greater than US$20 000 per carat, contributing a rough value of US$117.6 million (57% of Letšeng's revenue), compared to 187 diamonds in 2011, which contributed US$202.6 million (67% of Letšeng's revenue) in 2011.

Manufacturing and partnership

Continuing the Company's stated strategy to access margin further downstream by cutting and polishing diamonds and/or partnering on select diamonds, for the full year 2012, a total of 946 carats (1 624 carats in 2011) were extracted at a rough market value of US$31.6 million (US$68.6 million in 2011). Of the diamonds extracted for manufacture, US$10.4 million (US$1.2 million in 2011) remains on hand in inventory at year-end and is unrecognised in revenue for the Group. Despite the volatile and challenging trading conditions experienced during 2012 and the lower volume of diamonds manufactured in 2012, the revenue uplift achieved on those goods manufactured and sold was US$2.8 million.

Financial performance

Amidst difficult market conditions during 2012, which started with the downturn in late 2011, Letšeng Diamonds continued to deliver strong operational results with record carats recovered, generating revenue of US$207.7 million from diamond sales and underlying EBITDA of US$91.0 million. However, as a result of the 30% decrease in average US$ per carat achieved in the current year compared to 2011, there was a decrease of 50% in underlying EBITDA over the prior year.

Carats recovered:

114 350

2011: 112 367

US$ (millions)	Year-ended 31 December 2012[1]	Year-ended 31 December 2011
Sales	**207.7**	300.6
Cost of sales*	**(100.1)**	(95.4)
Royalty and selling costs	**(16.7)**	(24.5)
Underlying EBITDA	**90.9**	180.7
Physicals		
Tonnes treated	**6 551 434**	6 805 152
Waste tonnes mined	**17 396 233**	13 652 730[2]
Carats recovered	**114 350**	112 367
Carats sold[3]	**107 617**	107 700
US$ (per unit)		
Exchange rate (average)	**8.21**	7.26
Average price per carat (rough)	**1 932**	2 776
Direct cash cost (before waste) per tonne treated[4]	**13.18**	12.24
Operating cost per tonne treated[5]	**15.29**	14.07
Waste cash cost per waste tonne mined[6]	**2.97**	2.91
Local currency (per unit) Lesotho loti		
Direct cash cost (before waste) per tonne treated[4]	**108.24**	88.84
Operating cost per tonne treated[5]	**125.57**	102.15
Waste cash cost per waste tonne mined[6]	**24.40**	21.13
Other operating information (US$ millions)		
Waste capitalised	**60.6**	56.5
Waste amortised	**26.9**	18.6
Depreciation and mining asset amortisation	**17.7**	19.6
Capital expenditure[7]	**22.8**	14.2

* Excluding depreciation, mining asset amortisation and waste amortisation.

[1] Included in underlying EBITDA is US$10.4 million profit (31 December 2011: US$1.2 million) generated on the portion of diamonds sold to the Sales and Marketing company in the Group for cutting and polishing and not sold outside of the Group by the end of December. These values have been eliminated in the consolidated Group results.

[2] Revised waste tonnes mined for 2011, due to the survey review which was reported in the H1 2012 Trading Update

[3] Excludes sale of polished diamonds.

[4] Direct cash costs represents all operating costs, excluding royalty and selling costs, depreciation, mine amortisation and all other non-cash charges.

[5] Operating costs exclude royalty and selling costs and depreciation and mine amortisation, and include inventory, waste and ore stockpile adjustments.

[6] Not restated for revised waste tonnes mined (as reported at 31 December 2011).

[7] Capital expenditure excludes movements in rehabilitation assets relating to changes in rehabilitation estimates.

Business review
Letšeng continued

Larger operating fleet brought to site during 2012 to increase capacity

Major environmental incidents:

Zero

2011: Zero

Costs

Cost management has continued to be a key focus and Letšeng has managed to maintain its costs within expected targets. Local currency direct cash costs (before waste) per tonne treated for the year were Maloti 108.24 relative to the prior year of Maloti 88.84. This increase of 21% is mainly due to local inflation increases, fuel and power increases above local inflation, operational changes to drilling and blasting methodologies and the impact of lower tonnages treated during the year (down 4% from 2011). The lower tonnage treated was mainly due to the planned reduced throughput in the main Letšeng plants in December to assess any impact on diamond damage.

Total operating costs per tonne treated for the year increased to Maloti 125.57 per tonne from Maloti 102.15 per tonne, mainly as a result of an increase in waste amortisation costs (driven by the different waste to ore strip ratios for the particular ore processed) during the year and the lower production volumes. During the current year, Satellite ore contributed 25% of the total ore processed in 2012 compared to 16% in 2011.

Health, Safety, Social and Environment (HSSE)

Gem Diamonds is committed to meeting international best practice standards with respect to health, safety and social and environmental impacts at Letšeng and across all of its operations. The Company regards this as a key component of its business strategy and a key element of its success going forward. The Company is continually reviewing and enhancing its approach and initiatives in this regard and is pleased with the progress that has been made.

HSSE management at Letšeng showed a significant improvement in performance compared to 2011. This is supported by an improvement in Letšeng's independent SHE audit score from a 3 to a 4 Star rating in 2012. Regrettably in December, a non-mining related fatality occurred at the operation, shortly followed by an LTI. Comprehensive investigations into both incidents were undertaken and appropriate corrective actions implemented to prevent any reoccurrences. The completion of the operation's behaviour-based safety system was achieved in late 2012 and proactive SHE management has been significantly improved.

2012 saw the commencement of the construction of an engineered wetland at Letšeng, which will sustainably treat the mine's effluent prior to release into the ambient environment. Should this prove successful, this approach will be expanded upon.

Letšeng recorded zero major[1] environmental incidents, while recording one significant[2] incident which was immediately remediated. The operation remains on target to complete the update of its Social and Environmental Management Plan in early 2013. This plan will ensure compliance with the International Finance Corporation (IFC) Environmental, Health and Safety guidelines and performance standards, as well as with the Equator Principles.

Corporate Social Investment (CSI) at Letšeng continues to positively impact the lives of the project affected communities. The Company's flagship CSI projects, the Wool & Mohair and the Livelihoods projects, remain on target, with over 1 000 local farmers completing training in a variety of agricultural, entrepreneurial and business skills and in excess of 100 000 goats and sheep sheared during the year. Several other projects remain on-going.

[1] Incident which results in long term, high severity environmental impact.

[2] Short to mid-term, medium severity environmental impact incidents.

Evening at the Letšeng mine

Aerial view of the Letšeng mine

2013 and onwards

The focus for 2013 will be refining the studies around the Plant 1 and 2 upgrades, in conjunction with developing long-term mining scenarios to match the anticipated treatment capacity increase. Diamond damage studies will continue to examine all possible areas of influence from blasting in the pit to the relevant operations in the recovery process. Various blasting tests are currently underway and the programme to replace four crushing units in Letšeng's existing processing plants, mentioned above, is expected to result in immediate improvements by mid-year.

Additional exploration drilling is planned to be undertaken during the year to further increase knowledge of the resource. A number of holes are planned around the deeper sections of the Satellite pipe in order to support planning of the potential underground operation. Details of this drilling programme are given in the Mineral Resource section of the Annual Report.

Cost reduction will remain a focus and interventions are being put in place aimed at optimising treatment and mining unit costs, considering expected production profiles. Upgrading of the mining fleet to match future production requirements will continue. Negotiations with the various contractors are underway in order to support cost reduction initiatives considering the long life remaining at Letšeng. Aligned with cost management, the optimisation of medium-term waste stripping profiles will be a priority in order to maximise cashflow especially during periods of the anticipated capital expenditure on the two existing treatment plants.

As part of the development of Letšeng's downstream activities and capabilities, Letšeng is in the process of establishing an in-country manufacturing facility that will manufacture certain categories of its rough diamond production, utilising proprietary diamond processing technology. This facility is planned to be completed in the second half of 2013 and will reach full production capacity in 2014.

Case Study - Conserving Critical Habitat at Letšeng

Our operation at Letšeng borders the buffer zone of the Maloti Drakensberg Transfrontier Conservation Area, which is recognised as a global biodiversity hotspot due to the high diversity and richness of plant species, as well as the high prevalence of endemic species. With the revision of the International Finance Corporation's Performance Standards in 2012 relating to the management of living natural resources, we took the opportunity to implement yet another set of international best practice standards. We conducted a comprehensive Critical Habitat Assessment in 2012 to identify biodiversity impacts and develop optimal mitigation, management and offset measures. This resulted in the finalisation of the mine's Biodiversity Action Plan, which will be fully implemented in 2013 by an internationally recognised alpine vegetation specialist, newly appointed to the team.

The vegetation specialist is also responsible for co-ordinating the biodiversity monitoring programme; plant rescue and relocation; maintenance of the mine's unique biodiversity display garden; indigenous seed collection and plant propagation; rehabilitation measures; and oversight of biodiversity offset projects, such as the construction of the new engineered wetland.

For further detail please visit:
www.gemdiamonds.com

Business review
Ellendale

Ellendale is renowned worldwide for its production of rare fancy yellow diamonds, which comprise approximately 13% of Ellendale's total carats recovered in 2012. These diamonds are sold under an off-take agreement to Tiffany & Co. and accounted for 78% of Ellendale's total revenue for the year.

Gem Diamonds concluded the disposal of its 100% interest in the Ellendale Mine through the disposal of its wholly owned subsidiary, Kimberley Diamond Company NL, to Goodrich Resources Limited, for a consideration of US$15.4 million, effective as at 31 December 2012.

Diamond sales

	Year-ended 31 December 2012	Year-ended 31 December 2012
No. carats sold	**157 796**	121 454
Average US$ per carat	**720**	731

Operational highlights

- Carats recovered: 155 996
- Average US$ per carat: US$720
- Tonnes treated: 4.2 million
- Waste tonnes mined: 6.5 million

Sustainability performance

- LTIFR 0.51
- AIFR 11.64
- Achieved 32 months LTI free in May 2012
- Zero major environmental incidents
- Ellendale retained its 4 Star rating in the annual external SHE audit
- Fatality free since the operation commenced in 2002
- Land use agreement with the Bunuba People was completed in 2012 and US$1.9 million was paid into the Bunuba People's Trust

Emergency response training drill at Ellendale

Inspection of new tailings storage facility at Ellendale

2012 saw a much improved production performance at Ellendale after a difficult 2011. Tonnes treated increased by 34% year-on-year to 4.17 million tonnes and carats recovered increased by 28% to 155 996 carats. A major contributor to the improved volume performance was a number of modifications made to the screening and primary feed arrangements in the treatment plant that commenced towards the end of 2011. This resulted in a greater ability to handle the characteristic wet and sticky ore which had been severely impacting the plant's performance. The increase in tonnes treated was in turn underpinned by higher volumes from the pit as the mining contractor continued operating at a limited capacity through the wet season at the beginning of the year. The contractor, which was appointed in late 2011 as a result of a re-tendering process, performed well throughout the year and ore mined increased to 4.67 million tonnes, up 71% compared to 2011. This performance contributed to a healthy stockpile balance of 1.4 million tonnes at year-end.

In terms of ore tonnes mined and treated, 61% was sourced from the East pit and 39% from the West pit. This compares to 53% and 47% respectively in 2011. The increased mix from the higher grade East pit was planned to boost carat production, however recovered grade for the year was 3.74 cpht, 3% lower than the 3.86 cpht reported in 2011. The lower grade resulted primarily from progressing deeper into the East pit where the geology was found to be more complex than originally expected. With depth, the root zone of the pipe was encountered and areas which had been estimated as high grade were found to contain lower grade material.

Waste mining moved 6.5 million tonnes for the year compared to 6.2 million tonnes in the prior year. The year-on-year increase was mainly due to the higher proportion of mining from the deeper East pit with a commensurate increase in waste stripping being needed to access the ore.

Gem Diamonds concluded the disposal of its 100% interest in the Ellendale Mine (held within its wholly owned subsidiary, Kimberley Diamond Company NL ('Kimberley Diamonds')) to ASX listed company Goodrich Resources Limited ('Goodrich'), for a total consideration of US$15.4 million. The consideration comprises a cash payment of AU$3.2 million and the repayment of a secured loan by Kimberley Diamonds of US$11.5 million (payable in instalments over 23 months following completion). The sale was completed on 31 January 2013 and was effective as at 31 December 2012.

Sales and marketing strategy

Kimberley Diamonds sells its fancy yellow diamonds directly under an off-take agreement to Laurelton Diamonds, Inc., the diamond sourcing and manufacturing subsidiary of global high-end jeweller Tiffany & Co. During the year, pricing for the qualifying fancy yellow diamonds sold to Tiffany & Co. was reviewed and a new pricing floor to the existing indexed pricing mechanism was agreed. This new floor price became effective on 1 October 2012.

Kimberley Diamonds sells the remaining commercial rough production through an outsourced electronic diamond auction platform.

Prices achieved

In 2012, Kimberley Diamonds achieved an overall average price of US$720 per carat for its production, a decrease of 1.5% from the average price of US$731 per carat achieved in 2011.

Kimberley Diamonds achieved an average of US$4 393 per carat for Ellendale's rare qualifying fancy yellow diamonds that are sold to Tiffany & Co., representing a reduction of 0.3% against the average price per carat of US$4 409 in 2011. The prices in the fourth quarter of 2012 were positively impacted as a result of the new floor price introduced to the indexed pricing mechanism.

In 2012, Ellendale's commercial diamond production achieved an average price of US$181 per carat, which represents a decrease of 4% over the average price achieved in 2011 of US$188 per carat.

Financial performance

Kimberley Diamonds generated revenue of US$113.6 million compared to US$89.4 million achieved in the prior year. The increased prices achieved on the fancy yellow diamonds sold to Tiffany & Co. and the increase in carats recovered due to improved production, contributed to the 27% increase in revenue and the generation of a positive underlying EBITDA of US$12.4 million, a decrease of 6% from 2011. This decrease was mainly driven by the additional costs associated with increased production and a strong Australian dollar. The results of the operation are set out below. However as the company was disposed of with effect on 31 December 2012, the results of the operation are disclosed as discontinued operations in the Group results.

Business review
Ellendale continued

Ellendale E9 East from the air

Costs

The improved production performance at Ellendale, which resulted in higher tonnage treated, together with strict cost management, have positively impacted unit costs. A large portion of Ellendale's cost structure constitutes a fixed element resulting in local currency direct cash costs (before waste) per tonne treated for the year amounting to AU$16.89 relative to the prior year of AU$19.02.

Total operating costs per tonne treated for the year also decreased to AU$20.86 per tonne from AU$21.97 per tonne, mainly as a result of the higher production volumes and cost management referred to above.

US$ (millions)	Year-ended 31 December 2012	Year-ended 31 December 2011
Sales	**113.6**	89.4
Cost of sales*	**(94.3)**	(70.6)
Royalty and selling costs	**(6.9)**	(5.6)
Underlying EBITDA	**12.4**	13.2
Physicals		
Tonnes treated	**4 171 291**	3 116 017
Waste tonnes mined	**6 532 941**	6 183 668
Carats recovered	**155 996**	120 302
Carats sold	**157 796**	121 454
US$ (per unit)		
Exchange rate (average)	**0.97**	0.97
Average price per carat (rough)	**720**	731
Direct cash cost (before waste) per tonne treated[1]	**17.49**	19.63
Operating cost per tonne treated[2]	**21.60**	22.67
Waste cash cost per waste tonne mined	**4.60**	4.16
Local currency (per unit) Australian dollar (AU$)		
Direct cash cost (before waste) per tonne treated[1]	**16.89**	19.02
Operating cost per tonne treated[2]	**20.86**	21.97
Waste cash cost per waste tonne mined	**4.45**	4.04
Other operating information (US$ million)		
Waste capitalised	**36.1**	30.8
Waste amortised	**31.3**	18.7
Depreciation and mining asset amortisation	**18.2**	8.8
Capital expenditure[3]	**9.3**	15.7

* Excluding depreciation, mining asset amortisation and waste amortisation.

[1] Direct cash costs represents all operating costs, excluding royalty and selling costs, depreciation, mine amortisation and all other non-cash charges.

[2] Operating costs excludes royalty and selling costs and depreciation and mine amortisation, and includes inventory, waste and ore stockpile adjustments.

[3] Capital expenditure excludes movements in rehabilitation assets relating to changes in rehabilitation estimates.

Waste cash costs per tonne of waste moved was AU$4.45 up from the prior year of AU$4.04.

HSSE

Ellendale continues to achieve a high standard in HSSE management and retained its 4 Star rating in the external SHE audit for a third consecutive year. The operation has remained fatality-free since it commenced operation and achieved 32 months LTI free in May. Ellendale recorded zero major[3] environmental incidents and three significant[4] incidents, which were duly reported to the relevant authorities and appropriate remedial actions implemented. Extensive focus was paid to improving the operations' rehabilitation and closure plan during 2012 to ensure that a practicable, integrated and cost-effective rehabilitation plan could be implemented concurrently with mining activities. AU$0.9 million was spent on progressive rehabilitation in 2012.

The Company continued to contribute to the progress of its Project Affected Communities through supporting projects related to education, healthy lifestyles, regional environmental initiatives and a range of several worthy causes. Cross cultural awareness training continued in 2012, facilitated by the Traditional Owners of the Ellendale mine lease, the Bunuba people. The Bunuba People's Trust was finalised during late 2012 and US$1.9 million paid to the Trust in early 2013.

Total operating costs per tonne treated

AUS$16.89

2011: AUS$19.02

[3] Incident which results in long term, high severity environmental impact.
[4] Short to mid-term, medium severity environmental impact incidents.

Case Study – Optimising community benefit for the Bunuba people

Gem Diamonds takes its responsibility for ensuring good relations with its Project Affected Communities seriously and we strive to achieve a positive legacy that will remain long after the mineral resources have been depleted. We regard it as our duty to ensure the sustainable development of the communities amongst whom we operate and have a direct impact upon.

During the time of the Company's ownership of the Ellendale mine, much work has gone into identifying, developing and implementing a long-term sustainable Corporate Social Investment (CSI) project for members of Bunuba people of the Fitzroy Crossing area – the traditional owners of the land on which the Ellendale operation is located. Ideally a project of this nature is developed to function independently of the mining operation in order to avoid the 'boom and bust' cycle so often associated with the mining industry.

Based on the findings of a Community Investment Review and Audit in 2011, a community needs analysis was conducted during late 2011 in order to improve the appropriateness and sustainability of the Company's CSI investments in Australia. A community trust was determined to be the best vehicle for this, and the Bunuba People's Trust was created.

An annual land use compensation payment under the Bunuba Native Title and Compensation Agreement of 2004 was agreed with the Bunuba people and in January 2013, the Company paid US$1.9 million into the Bunuba People's Trust. This amount, together with additional funds for legal fees and other costs incurred by the traditional owners, and a portion of this was paid in lieu of share options, which were no longer available to the Bunuba people due to the delisting of Kimberley Diamond Company from the Australian Stock Exchange after its acquisition by Gem Diamonds in 2007. These funds are available immediately for community motivated projects to be undertaken.

For further detail please visit:
www.gemdiamonds.com

Business review
Ghaghoo

The Ghaghoo diamond mine in Botswana is currently being developed by the Company's wholly-owned subsidiary, Gem Diamonds Botswana, which holds a 25 year mining licence. 'Ghaghoo' is the name of a locally abundant camel thorn acacia tree, and is the name historically used by locals to refer to the area, before geological exploration teams arrived over 30 years ago

The Ghaghoo Underground Project is currently underway with Phase 1 development which is intended to provide confirmation of diamond prices, grade and diamond recovery characteristics to enable a more definitive way forward for Ghaghoo to be defined. Progress increased substantially during 2012, however sadly this was marred by a fatal accident where two contractor employees lost their lives. This is set out in more detail in the HSSE section of the Annual Report.

Tunnel development for the access decline commenced in the fourth quarter of 2011 and will reach a depth of approximately 150 metres below surface from whence production will commence. The first 70 metres of vertical depth is through Kalahari Sand and an Open Face Tunnelling Shield is being used to advance through the sand until reaching basalt. From this point on, conventional drill and blast techniques will be used to tunnel down to the 150 metre level and develop into the kimberlite ore-body. Sub-level caving will then be used as the production method which will ramp up to a capacity of approximately 720 000 tonnes per annum.

Difficulties were encountered while tunnelling through the sand and a number of unexpected areas of very hard calcrete have also been encountered. This caused a change to the tunnelling procedure, and drilling and blasting had to be introduced. In conjunction with the accident mentioned above, these events have resulted in a significant delay to the access decline's progress. After reviewing the expected time-line going forward and taking into account what is likely to be slower than planned progress in the remainder of the sand tunnel, the commencement of Phase 1 production has been moved out to mid-2014 from the original planned date of mid-2013.

As at 31 December 2012, the sand portion of the access decline had reached a depth of 43 metres or 218 metres of decline development. A further 298 metres of decline development is required to reach the basalt interface.

Pre-project preparation, including surface works for the commencement of sinking the ventilation shaft is well progressed and it is planned that work on this will commence after the completion of the sand portion of the access decline.

Installation of the autogenous mill at Ghaghoo

Treatment plant at Ghaghoo

Access decline through the Kalahari sand

Construction of the treatment plant progressed well throughout the year and was substantially complete at year-end. An autogenous grinding mill has been installed and is in the process of being commissioned. The autogenous milling process is expected to improve diamond liberation through a finer grind compared to conventional milling, which therefore increases the recovered grade. This will have a positive effect on revenue and is one of the key result areas for Phase 1 of the project.

The camp-site infrastructure was completed during 2012 and installation of on-site power generation completed which will be used throughout Phase 1. A number of boreholes have been drilled which will supply water for the processing plant while additional ground-water from the underground workings is expected to supplement borehole capacity. Currently, the amount of water being pumped from the boreholes is exceeding expected capacity.

During 2012, US$32.7 million was spent on the project. Due to the delays described above, the total Phase 1 capital budget has been increased to US$96 million from the original US$85 million.

HSSE

The development of the Ghaghoo HSSE system remains on-going as construction and operational activities expand. The Company has made great strides with its social and community engagement programmes in Botswana, with a focused and comprehensive framework in place to guide future initiatives. The Company successfully completed a community water supply programme for two settlements in the Central Kalahari Game Reserve and is currently assessing options to supply a further two communities with drinking water. At year-end, 30% of the Company's employees were recruited from the Project Affected Communities.

Tragically, two fatalities occurred at the operation in a fall of ground incident in May 2012. Extensive remedial actions were implemented in the access decline before mining resumed in September. An additional two Lost Time Injuries were recorded during the year. Zero major and/or significant environmental incidents were recorded in the reporting period.

As a priority, Gem Diamonds is focused on minimising all negative impacts as far as possible and working towards ensuring the best interests of its employees, affected communities and the environment.

2013 onwards

Work will continue on the access decline development with subsequent access to the ore-body to follow. Activities related to the sinking of a ventilation shaft for the underground mine are underway. The remainder of the processing plant will be completed and commissioned. Studies are continuing to asses various long-term mining and processing scenarios which, depending on the outcome of Phase 1 and the expected economic outlook, will determine the next stage of the Ghaghoo Project.

During 2013, US$40.2 million of the capital budget remains to be spent.

Short-term labour programme changing Kaudwane residents' lives

Many of the residents of the Ghaghoo mine's Project Affected Community, Kaudwane, have never been employed. This is true of Oduetse Moloreng, born in the Gope settlement, who we employed at the age of 22 to work in the Ghaghoo mine's kitchen. Oduetse quickly proved himself to be a valued employee and was elected by his peers to become their Safety, Health and Environmental Representative. Says Oduetse of his new position: "I was looking for a job that I really enjoy and I think I found it. While I am still learning, I am a people's person and this job has me working with lots of people around and serving my customers. Everybody pitches in when the work needs to be done, including the managers. I'm a happy person and if someone walks away being happy, then I've done my job."

The importance of employing Oduetse and others from the Kaudwane village is an operational imperative for Ghaghoo: "I can understand how people in our community get trapped by unemployment. Lack of education is much of it and when you grow up, you see parents and aunties and uncles who didn't finish school and didn't have jobs. It's easy to think that if they didn't need a job, you don't need it either. We returned from the Ghaghoo Diamond Mine with a different perspective about the world. We even interact with people differently now – not as people from Kaudwane, but as world citizens", says Oduetse.

Business review
Gem Diamonds marketing and manufacturing

Gem Diamonds' marketing arm was formed in 2010 and is responsible for designing and implementing the sales and marketing and manufacturing strategies as defined by the Group and subsidiary boards. Gem Diamonds maximises revenue from actively marketing its rough and polished diamonds through a combination of channels, including tenders, auctions, direct sales, off-take arrangements and partnerships. In May 2012, Gem Diamonds established a high-tech analytical and manufacturing capability in Antwerp as part of the strategic objective to increase revenue for its rough diamonds and access additional margins further along the diamond pipeline.

Sales and marketing

The Group's rough diamond production is marketed primarily in Antwerp through the use of electronic sales (eSales) technology platforms (eTenders and eAuctions) that are designed to enhance engagement with customers more frequently, dynamically and transparently. This helps ensure the achievement of fair market-driven prices for the Group's diamond production. Polished diamonds are sold directly to clients.

The Letšeng diamond production is sold on eTender and is marketed by Gem Diamonds Marketing Services BVBA, a wholly-owned Group subsidiary based in Antwerp, Belgium.

The Kimberley Diamonds ('Kimberley') commercial diamond production was marketed through an outsourced service provider via eAuctions in Antwerp and Kimberley's higher value qualifying fancy yellow diamond production was sold to Tiffany & Co. through the Life of Mine off-take agreement.

The Group continues to invest and grow the intellectual know-how in its marketing and manufacturing operations with the objective of ensuring that the highest returns are achieved on its production, in rough or polished form.

Manufacturing

The Group continued to invest in and build its manufacturing expertise and capacity during 2012. A high-tech diamond analysis and manufacturing operation focusing on large, top quality diamonds was established in Antwerp in the second quarter of 2012.
The Group also commenced the establishment of an operation in Mauritius in the second half of 2012, which will see the deployment of the Calibrated laser cutting technology. The analytical and manufacturing capability, and the polished sales and partnering arrangements provide the Group with a more complete understanding of the value of the Letšeng high-end production as well as access to margins beyond the mine gate.

Continuing the Company's stated strategy to access margin further downstream by cutting and polishing diamonds and/or partnering on select diamonds, for the full year 2012, a total of 946 (1 624 carats in 2011) were extracted at a rough market value of US$31.6 million (US$68.6 million in 2011). Of the diamonds extracted for manufacture, US$10.4 million (US$1.2 million in 2011) remains on hand in inventory at year-end and is unrecognised in revenue for the Group in 2012. Despite the volatile and challenging trading conditions experienced during 2012 and the lower volume of diamonds manufactured in 2012, the overall uplift achieved on those goods manufactured and sold was US$2.8 million.

Business review
Other assets

Due to the current global market conditions and the resulting impact on diamond prices, Gem Diamonds formally withdrew from the Chiri project in Angola at the end of November 2012.

Since its inception, a total of US$14.8 million has been spent at Chiri as at 31 December 2012. Following the decision to withdraw from Angola, this amount has been written off. Of the total US$14.8 million spent at Chiri, US$5.6 million was advanced as a loan to the project partner and is subject to a continuing right of repayment should the project go ahead at any time in the future (irrespective of Gem Diamonds' involvement). The write-off of this asset has been disclosed as an exceptional item due to its non-recurring nature.

Business review
Group financial performance

Revenue

US$202.1 million

2012 was a difficult year in the diamond market with global market conditions impacting diamond revenue. The Group reports* revenue of US$202.1 million, underlying EBITDA of US$65.5 million, and profit for the year before exceptional items of US$32.6 million. The disposal of the Kimberley Diamonds operation was concluded with effect on 31 December 2012. Notwithstanding the difficult trading conditions, the Group generated positive earnings of 12 US cents before exceptional items.

US$ (millions)	12 months ended 31 December 2012 before exceptional items	Exceptional items	12 months ended 31 December 2012 Total	12 months* ended 31 December 2011
Revenue	**202.1**		**202.1**	306.1
Cost of sales[1]	**(103.3)**		**(103.3)**	(97.8)
Royalty and selling costs	**(19.1)**		**(19.1)**	(26.5)
Corporate expenses	**(14.2)**		**(14.2)**	(15.3)
Underlying EBITDA	**65.5**		**65.5**	166.5
Depreciation, mining asset amortisation and waste amortisation	**(18.6)**		**(18.6)**	(21.6)
Share-based payments	**(2.3)**		**(2.3)**	(1.3)
Impairments		**(16.2)**	**(16.2)**	-
Other income[2]	**1.3**		**1.3**	-
Foreign exchange gain	**3.8**		**3.8**	6.8
Net finance income	**1.3**		**1.3**	2.1
Profit before tax	**51.0**	**(16.2)**	**34.8**	152.6
Income tax expense	**(18.4)**		**(18.4)**	(52.9)
Profit for the year from continuing operations	**32.6**	**(16.2)**	**16.4**	99.7
(Loss)/profit from discontinued operations		**(70.3)**	**(70.3)**	6.2
Recycling of foreign currency translation reserve on disposal of subsidiary		**(48.4)**	**(48.4)**	
(Loss)/profit for the year	**32.6**	**(134.9)**	**(102.3)**	105.9
Non-controlling interests	**(15.5)**		**(15.5)**	(38.2)
Attributable profit/(loss)	**17.1**		**(117.8)**	61.5
Earnings per share (US cents)	**12.4**		**(85.0)**	49.0
Earnings per share – (continuing operations (US cents)			**12.4**	44.0

* The results of the Kimberley Diamond operation have been included in Discontinued operations and the prior period's figures have been restated for the reclassification impact of accounting for discontinued operations.

[1] Excluding depreciation, mining asset and waste amortisation.

[2] Included in other income is the gain on revaluation of mark to market financial instruments amounting to US$1.2 million.

As a result of the disposal of the Ellendale mine, the Group's results are reported excluding the Kimberley Diamonds' operation as these are now disclosed as part of discontinued operations. The comparative results have been restated to exclude Kimberley Diamonds in accordance with IFRS.

Financial performance (before exceptional items)

Revenue was generated primarily from the sale of rough diamonds recovered at the Letšeng mine. In addition, the sale and marketing division has contributed to Group profitability through the management of the manufacturing process and downstream initiative, which has resulted in Letšeng generating US$2.8 million in additional revenue. Royalties and selling costs of US$19.1 million mainly comprise mineral extraction costs paid to the Lesotho Revenue Authority of 8% on the sale of diamonds and diamond marketing related expenses. The internal sales and marketing structure formed by the Group in late 2010, has resulted in a reduction in Letšeng's selling costs from 2.5%, to 1.5%. As a result of managing the sales and marketing internally, the Group underlying EBITDA in 2012 is improved by US$3.6 million generated through reduced selling and marketing costs and a strong contribution from that division.

Cost of sales for the period was US$103.3 million before non-cash costs of depreciation of US$16.0 million and amortisation on mining assets of US$2.6 million.

Underlying EBITDA for the year was US$65.5 million, down from the prior year by US$101.0 million from US$166.5 million. This is predominately driven by the lower revenue achieved by the Group which reduced by US$104.0 million from 2011. This is represented by the average US$ per carat achieved at Letšeng of US$1 932 for 2012, compared to US$2 776 in 2011. Profit attributable to shareholders for the year before exceptional items was US$17.1 million, equating to 12 US cents per share on a weighted average number of shares in issue of 138 million. The Group incurred an overall attributable loss of US$117.8 million post the impact of exceptional items, including discontinued operations resulting in a loss per share of 85 US cents per share.

Corporate expenses relate to central costs incurred by the Company and its services subsidiary, Gem Diamond Technical Services. Corporate expenses were US$14.2 million, positively impacted by the stronger US$ during the period (a large portion of corporate costs are in South African Rand), and exclude one-off project costs of US$1.6 million resulting in total corporate costs of US$15.8 million in 2012. Corporate costs do not include the positive financial contribution generated by the Group from the implementation of the sales and marketing structure noted above.

The Lesotho Loti (pegged to the South African Rand) weakened significantly during the latter part of 2011. This weakened rate together with a further weakening in the latter part of 2012 resulted in the average rate for 2012 being 13% weaker than the average in 2011. The Australian dollar has maintained its strong trading levels during the year resulting in a strong average local currency level similar to that of the prior year.

The following table details the relative exchange rates for 2012 compared to 2011:

	FY 2012	H2 2012	H1 2012	FY 2011	Variance FY 2012 to FY 2011
Lesotho Loti per US$1.00					
Average exchange rate for the year/period	**8.21**	8.48	7.94	7.26	13%
Year/period end exchange rate	**8.48**	8.78	8.18	8.07	5%
Australian dollar per US$1.00					
Average exchange rate for the year/period	**0.97**	0.97	0.97	0.97	0
Year/period end exchange rate	**0.96**	0.94	0.98	0.98	2%

Business review
Group financial performance continued

Exceptional items

On 30 January 2013, the Company concluded the sale of its 100% interest in the Ellendale Mine through the disposal of its wholly owned subsidiary, Kimberley Diamond Company NL, to Goodrich Resources Limited, for a consideration of US$15.4 million, effective as at 31 December 2012. Up until the date of the disposal, Kimberley Diamonds incurred a trading loss in 2012 of US$6.6 million. As a result of the disposal of the operation, an additional loss of US$63.7 million was incurred being the fair value adjustment to bring the carrying value of the operation in line with its fair value of the total consideration of US$15.4 million (net of costs to sell). This consideration receivable has been disclosed in other assets on the Balance Sheet. Due to currency fluctuations of the Australian dollar since the Groups' investment into Kimberley Diamonds up until the disposal, the Group incurred a loss of US$48.4 million which represents recycling of foreign currency translation reserve as a result of the disposal.

Gem Diamonds formally withdrew from the Chiri project in Angola at the end of November 2012 due to the current global market conditions and the resulting impact on diamond prices. Since its inception, a total of US$14.8 million has been spent at Chiri as at 31 December 2012. Following the decision to withdraw from Angola, this amount has been written off. Of the total US$14.8 million spent at Chiri, US$5.6 million was advanced as a loan to the project partner and is subject to a continuing right of repayment should the project go ahead at any time in the future (irrespective of Gem Diamonds' involvement).

Following the review of the current Project Kholo in light of the existing and expected global economic outlook, the project was scaled back with a focus towards a lower, more capital efficient project. As a result an amount of US$1.4 million of the current project costs incurred were considered impaired as they could not be used in the revised project plans.

These items have all been disclosed as Exceptional Items separately in the Income Statement and amount to a total of US$134.9 million impacting overall earnings per share by 97 US cents.

Share-based payments

Share-based payment costs for the year amount to US$2.3 million, comprising the allocation of the share option award in 2010 which expired in 2012 and for which no vesting took place, and the share option award in 2011 which expires in 2014. On 20 March 2012, the Company announced 1.3 million share options were awarded to Directors and senior employees. On 11 September 2012, a further 0.9 million share options were awarded to senior employees, other than Directors. The share-based payment cost associated with these new awards has impacted the current year's charge by US$1.2 million.

Forex

Foreign exchange gains relate to gains and losses on the conversion of US dollar revenue into local currency at Letšeng, gains and losses on exchange rate fluctuations on Sterling denominated cash held by the Company and realised hedges entered into by the Group during the period.

Net finance income

Net finance income comprises the net of interest received of US$2.6 million, predominantly generated on surplus cash from the Letšeng operation, against US$1.3 million charged to the Income Statement, representing the impact of unwinding the current environmental provisions.

Tax

The effective tax rate in the year for the Group is 53.0% from continuing operations, above the UK statutory tax rate of 24.5%. The increase over the statutory rate is predominately driven by the dividends declared at Letšeng during the year which result in a 10% withholding tax payable in Lesotho. The tax rate of the Group is driven by tax of 25% on profits generated by Letšeng Diamonds, withholding tax of 10% on dividends, tax impact on exceptional items and deferred tax assets not recognised on losses incurred in non-trading operations.

Non-controlling interest

Non-controlling interest represents 30% of the profits in Letšeng Diamonds, which is attributable to the Company's partner, the Government of the Kingdom of Lesotho.

Cash and debt

The Group has US$67.8 million (net of facility draw down at Letšeng of US$2.9 million) cash on hand (of which US$62.8 million is attributable and US$0.2 million is restricted).

Group cash was supplemented by a net cash inflow generated from operations for the year of US$143.7 million. Investments in property, plant and equipment amounted to US$165.6 million. The largest component of this investment was US$96.6 million, incurred in waste stripping at both mining operations. For Letšeng US$22.8 million of plant and equipment investment relates to infrastructure costs associated with the Life of Mine extension and initial costs relating to the expansion project and associated infrastructure. For Kimberley Diamonds US$9.7 million relates to infrastructure costs associated with additional slimes capacity, modifications to the primary plant feed section of the processing plant. For Ghaghoo US$32.7 million relates to the development of the underground mine in Phase 1.

During the year total dividends declared by Letšeng were US$31.0 million, which resulted in a net cashflow of US$19.5 million to Gem Diamonds and a cash outflow from the Group as a result of withholding taxes, of US$2.2 million and payments of the Government of Lesotho's portion of the dividend of US$8.8 million. As at 31 December 2012 US$2.9 million of the Letšeng facility was drawn down (this amount was repaid in full in January 2013).

In addition to the Maloti 250 million (US$29.5 million) 3-year unsecured revolving credit facility at Letšeng concluded in late 2011, Gem Diamonds has concluded and signed a US$20.0 million 3-year unsecured revolving credit facility with Nedbank Capital (a division of Nedbank Ltd), which is available for draw-down. As at the date of this report, the Group now has US$50.0 million of working capital facility available.

Events subsequent to the year-end

In January 2013, the Company concluded its facility agreement with Nedbank Capital. The facility is an unsecured, US$20.0 million, 3 year working capital revolving facility and is available for draw down.

On 31 January 2013, the Group concluded the sale of its 100% interest in the Ellendale Mine (through the sale of a wholly owned subsidiary, Kimberley Diamond Company NL ("Kimberley Diamonds")) to ASX listed company Goodrich Resources Limited ("Goodrich") effective 31 December 2012.

No other fact or circumstance has taken place during the period covered by the financial statements and up to the date of this report which in our opinion, is of significance in assessing the state of the Group's affairs.

Governance

Gem Diamonds is an independent company which finances its own operations via a decentralised corporate model. It does not rely upon any financial support from the Government of any country in which it operates and complies with, and benefits from, as appropriate and legitimate, all legal and regulatory requirements to operate.

No actions relating to anti-competitive behaviour, anti-trust and/or monopoly practices have been taken against Gem Diamonds.

It is now almost 12 years since the Kimberley Process was introduced to the diamond industry. The process has grown in reputation and has contributed to the virtual eradication of the trade in conflict diamonds. Gem Diamonds is firmly committed to the principles of the Kimberley Process and all diamonds sold by the Group are Kimberley Process certified.

Business review
Mineral resource management

Mineral resource management programmes continued at both the Letšeng and Ellendale operations, monitoring resource performance in terms of grade and revenue, together with resource development initiatives.

Resource performance

The resource performance (grade and US$ per carat revenue) is measured against the end of 2012 resource statement estimates (see Mineral Resource Statement Reporting section below). Grade reconciliation is based on expected carat production from provenance analysis of the various facies loaded and treated on a daily basis, versus the actual carats recovered. The US$ per carat revenue reconciliation is calculated in a similar manner based on ore provenance analysis versus the actual revenue realised from the relevant tender period. These resource measurements are important as they highlight possible resource under/over-estimation, process problems and also, importantly, price gaps due to a changing market environment. (Note that the ore treated by the contractor miner, "Alluvial Ventures" is excluded from the Letšeng reconciliation. Alluvial Ventures produces only 10% of the annual carats at Letšeng, using a different treatment process and for this reason is excluded from the resource reconciliation calculation).

Letšeng Plant 2

Annual grade reconciliation

- The Letšeng 2012 annual grade reconciliation was 94% or 6% below expected (1.86 cpht actual versus 1.98 cpht expected). This was largely the result of lower than expected grades recovered from the recently intersected K6 ore phase in Main pipe (2.43 cpht actual versus an expected resource grade of 2.81 cpht).
- The Ellendale 2012 annual grade reconciliation was 88% or 12% below expected (3.74cpht actual versus 4.27cpht expected). This was largely due to plant inefficiencies mainly caused by poor water quality.

Annual revenue reconciliation

The Letšeng 2012 annual revenue reconciliation was 71% or 29% below expected (US$1 958 per carat actual versus US$2 768 per carat expected). This is due to a combination of factors:

- prices declined by 15% from the January 2012 resource estimate
- lower than expected diamond revenue from the K6 ore phase; and
- value loss through breakage of Type II stones

The Ellendale 2012 annual revenue reconciliation was 98% or 2% below expected (US$701 per carat actual versus US$714 per carat expected). Re-negotiation of the floor index for the Tiffany quality goods with Laurelton in the last quarter helped achieve this result.

At Letšeng discrete production samples from individual zones totalled 583 107 tonnes, producing 12 295 carats at an average grade of 2.11 cpht, slightly lower than the expected grade of 2.29 cpht.

At Ellendale 18 discrete production samples were collected across all zones in the E9 orebody, totalling 189 339 tonnes and 6 892 carats. These production samples produced an average grade of 3.64 cpht, slightly lower than the expected grade of 4.25 cpht.

Resource development

At Letšeng a comprehensive infill and deep drilling core programme, on both the Satellite and Main kimberlite orebodies, was completed in December 2012. The objectives were to increase geological and geotechnical knowledge on the existing resource as well as define additional resources below the current depth limits. A total of 18 holes or 8 740 metres were drilled during the campaign. In terms of the resource extension at depth, approximately 230 metres of additional ore was delineated below the Satellite pipe and 320 metres for the Main pipe. This extends the existence of the two pipes to 828 metres and 793 metres below surface respectively (current mining in both pits extends to 160 metres below surface). Together, these depth extensions are expected to add approximately 90 million tonnes to the Letšeng resource. Although the drilling encountered a number of challenges both from a weather and an operating perspective, the overall core recovery was 99% which is an excellent achievement. An updated resource model is expected to be completed by the end of the first quarter in 2013 which will confirm the additional tonnage along with any other changes to the resource.

At Ellendale the resource development work was restricted to bulk sampling of the E11 satellite lamproite. This work returned an uneconomic grade of 0.9 carats per hundred tonnes from the 6 690 tonnes of material processed.

Mineral resource statement reporting

An independent resource statement was prepared for Gem Diamonds by Venmyn Rand in the first quarter of 2012.

In the following summary table, prepared by Gem Diamonds, total resources (not attributable) are stated, inclusive of reserves.

For the detailed statements please see:

http://www.gemdiamonds.com/gem/en/investors/resource_statement/

Gem Diamonds is currently updating the resource models for the resource base and re-estimating grade and revenue estimates, taking into account the data generated during 2012. These revised estimates will be released in the second quarter of 2013.

Resource Development

90 million tonnes

added to Letšeng's resource

Resource		Indicated resources				Inferred resources				Total resources			
Country	Ownership	Ore (mT)	Grade (cts/100T)	Carats (m)	$/ct	Ore (mT)	Grade (cts/100T)	Carats (m)	$/ct	Ore (mT)	Grade (cts/100T)	Carats (m)	$/ct
Lesotho – Letšeng	70%	70.7	1.81	1.28	2 739	140.9	1.94	2.73	2 885	211.6	1.90	4.01	2 839
Botswana – Ghaghoo	100%	79.4	19.51	15.49	259	28.8	17.52	5.04	257	108.2	18.98	20.53	259
Australia – Ellendale	100%	14.7	5.27	0.78	376	76.6	4.18	3.20	229	91.3	4.35	3.98	258
Total		164.8	10.64	17.55	445	246.2	4.46	10.98	904	411.1	6.94	28.52	621

Business review
Principal risks

Risks to the business: The Group's operational and growth performance is influenced and impacted by a number of risks. Although many of these are beyond the control of the Group, a formal risk management process exists to assist in identifying and reviewing potential risks. Mitigating plans are formulated and reviewed regularly to gain an understanding of their effectiveness and progress. The Group is focused on continuously analysing and assessing the risks it faces and improving the risk management process accordingly. The following key risks have been identified by the Group. It is by no means an exhaustive list and may change over a period of time, as the impact and likelihood of the risks is assessed as part of the risk management process.

Market risks pertinent to the Group

Commentary	Mitigation	Trend (from 2011)
The period and stability of the recovery of the financial markets and the impact on consumer preferences post the 2008 global economic crisis impacts the Group and the industry as a whole. The further downturn in the diamond market in late 2011 emphasises the volatility and uncertainty in the recovery periods. This potentially compounds the existing short-term imbalance between demand and supply and the impact that this has on the diamond pipeline. Diamond prices remain volatile and sensitive to market uncertainties which have a direct impact on cash flows.	A change in consumer preferences away from diamonds due to negative sentiment towards diamonds and/or diamond mining is a continuing risk. Although the Group cannot materially influence the situation, the market conditions are continually monitored to identify current trends that will pose a threat or create an opportunity for the Group. The Group has flexibility to reassess its capital projects in light of current market conditions to preserve cash balances on its balance sheet.	→

Operational risks pertinent to the Group

Commentary	Mitigation	Trend (from 2011)
Mineral resource risk The Group's ability to operate profitably in the medium to long term depends heavily on knowledge of the Group's mineral resource, which influences the operational mine plans and the generation of sufficient margins.	Various bulk sampling programmes combined with geological mapping and modelling methods significantly improve the Group's understanding of the mineral resources and assist in mining the existing mineral resources profitably.	→
A major production interruption at Letšeng Diamonds The Group may experience material mine and/or plant shutdowns or periods of decreased production due to a number of different events. Any such events could negatively affect the Group's operations and impact both profitability and cashflows.	The continual review of the likelihood of possible different events and ensuring that the appropriate management controls, processes and business continuity plans are in place to mitigate this risk.	→
Health, safety, social and environmental responsibility related risks The risk that a major health, safety, social or environmental incident may occur within the Group is inherent in mining operations.	The Group has reviewed and published policies in this regard and significant resources have been allocated to continuously improve, review, recommend, implement and monitor compliance throughout the various operations within the Group. Further to this, the Group engages independent third parties to review and provide assurance on processes currently in place.	→
Diamond theft Theft is an inherent risk factor in the diamond industry.	All the necessary precautions have been put in place in order to minimise this risk.	→

Political risks pertinent to the Group

Commentary	Mitigation	Trend (from 2011)
The political environments of the various jurisdictions that the Group operates within may adversely impact the ability to operate effectively and profitably.	The Group prioritises workforce localisation and compliance to host country legislation is a minimum compliance standard. Furthermore, changes to the political environment are closely monitored.	⇨

Financial risks pertinent to the Group

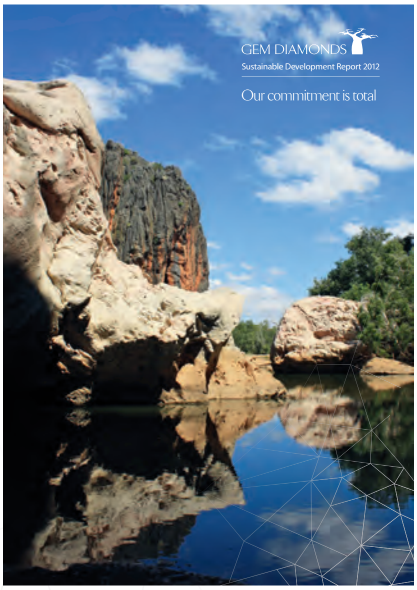
Commentary	Mitigation	Trend (from 2011)
Exchange Rates The Group receives its revenue in US dollars while its cost base arises in local currencies based on the various countries within which the Group operates. The weakening of the US dollar relative to these local currencies and the volatility of these currencies trading against the US dollar will impact the Group's profitability.	The impact of the exchange rates and fluctuations are closely monitored. Where appropriate and at relevant currency levels, the Group enters into exchange rate contracts to protect future cash flows.	⇨
Inability to achieve profitability and cash generation in the medium to long term The financial impact of the risks that may affect the Group may individually, or in a combination, affect the ability of the Group to operate profitably and generate positive cash flow in the medium to long term.	The various risk management processes described above provide a substantial base from which to assess, monitor and mitigate this risk.	⇨

Growth plans

Commentary	Mitigation	Trend (from 2011)
Inability to achieve planned growth The Group's growth strategy is based on various studies, cost indications and future market assumptions. Although due process in assessing the viability, costs and implementation of these projects is undertaken, risks with regards to cost overruns and/or delays may impact the effective implementation thereof. The funding of these growth plans could also be adversely affected by negative market conditions.	Project governance structures have been implemented to ensure that the projects are monitored and risks managed at an appropriate level. Strict treasury management procedures are also in place to monitor this risk.	⇨

Business review
Sustainable Development Report

This year, Gem Diamonds produced its fifth Sustainable Development Report based on Global Reporting Initiative (GRI) guidelines. This section comprises a brief summary of its progress in Corporate Social Responsibility (CSR). The Company has continued to evolve its Sustainable Development framework and implementation programme. The Company encourages shareholders and stakeholders to access the full 2012 Sustainable Development Report on the Gem Diamonds website, www.gemdiamonds.com



By publishing the Gem Diamonds Sustainable Development Report on an annual basis, the Company strives to improve communication with all stakeholders. The main purpose of the report is to demonstrate the Group's progress and commitment to conducting business in a responsible and ethical manner.

Our approach to sustainability

Gem Diamonds maintains a commitment to the integration of sustainability as a core business strategy. The effective implementation of its strategy for sustainability underpins Gem Diamonds' business resilience to ensure on-going benefits to all of its stakeholders.

In all instances, the Company operates within the context of a greater economic, social and ecological system. Gem Diamonds has the view that operating within such systems creates the moral and ethical responsibility to understand and manage the actual and potential impact of its operations for the greater good. Compliance to host country legislation is a minimum compliance standard for all of the Company's operations and it continually assesses and implements relevant international best practice standards relating to CSR in order to optimise benefit to the greater society.

Gem Diamonds recognises the importance of sustainable business processes and is committed to the development, implementation and maintenance of internationally recognised standards of health and safety, environmental, social, economic and business management, in order to conduct its business with due care and respect for people and the environment.

Creating sustainable value

Gem Diamonds continues to research and implement ways in which it can optimise both financial and socio-economic return on investment for its shareholders and stakeholders alike.

Against the backdrop of today's uncertain market and global economic conditions, a decision was taken in late 2012 to curtail expenditure on the Letšeng expansion project in order to preserve the Group's available capital and, in so doing, to ensure the financial sustainability of the Company. Expansion at Letšeng will continue, albeit in an altered manner to the initial plans, and will ensure that the Group achieves its financial goals. Construction of the Ghaghoo mine continued at a slower than planned pace in 2012 due to unexpected challenges related to ground conditions in the sand portion of the access decline. The construction phase is now expected to be completed during 2014, at which time production will commence.

Group Wide Local Contributions (US$ million)	2012
Project Affected Community based purchasing/ procurement	**28.0**
Regional based purchasing/procurement	**140.1**
Total in country purchasing/procurement	**241.9**
Project Affected Community based local employee costs	**7.1**
Regionally based local employee costs	**19.0**
Total in country based local employee costs	**39.7**

The Group's strategy to expand its presence further along the diamond pipeline in order to capture additional margins, has resulted in the successful establishment of cutting and polishing facilities in Antwerp and Mauritius respectively during 2012. The Group continues to investigate ways to increase its profitability in a responsible and sustainable manner and continue to contribute to the local economies in which it operates.

All Gem Diamonds' subsidiaries continue to contribute to the host country economies in which they operate through payment of all statutory taxes and other financial obligations. In addition, the Company's commitment to creating a lasting and positive socio-economic legacy extends beyond its legal obligations. Therefore, all operations have programmes in place to maximise local and regional employment and procurement. The success of this strategy is evident through the 47% increase in Project Affected Community and 40% in regional salary expenditure since 2010. Project Affected Community procurement has increased by 33%, while regional procurement has increased by 45% over the same period.

Governance

Being listed on the London Stock Exchange, Gem Diamonds has voluntarily adopted the most rigorous and widely recognised international best practice standards in respect of financial, corporate governance and CSR matters.

Appropriate Health, Safety, Social and Environmental (HSSE) policies, procedures and management systems have been developed and implemented at each operation, which ensures adherence to the relevant host country and international standards of best practice. Operational management structures are in place at each operating subsidiary to facilitate inclusive and transparent communication at all levels of the business, while providing the required assurance to the operational Boards. This year has seen an expansion in the number of technical Committees that have been formed at operational level. These Committees include subject matter experts and serve to address crucial focus areas such as pit stability and incident investigation.

The operations are supported by Gem Diamonds' HSSE Committee at Board level which is responsible for the implementation of Group level policies, standards and strategic guidance in respect of HSSE matters. The Committee reports directly to Gem Diamonds' Main Board and provides assurance in respect of the appropriateness and adequacy of operational HSSE management.

As throughout the Company's history, no cases of bribery, corruption, anti-competitive behaviour, anti-trust and/or monopoly practices were brought against the Company or its subsidiaries in 2012 and the Company continues to refine its policies and practices to prevent such practices from occurring.

In terms of Gem Diamonds' governance policies, no financial contributions are made to political parties, politicians or any other related institutions. All financial contributions made to host country governments relate to regulatory taxes.

Business review
Sustainable Development Report continued

Compliance with voluntary standards

The Company has at the core of its business philosophy the application of the Triple Bottom Line principle. Each operation manages its own unique risks and opportunities in a manner that is most appropriate to its circumstances and operational conditions, allowing management flexibility, creativity and independence in the decision making process.

Gem Diamonds continues to apply the principles of the International Finance Corporation (IFC) Environmental, Health and Safety (EH&S) guidelines and standards, as well as the Equator Principles as its international best practice guidance standard.
The operational Safety, Health and Environmental management systems are based on the principles of ISO 18000 and ISO 14001, while the Global Reporting Initiative (GRI), serves as the reporting basis for the Company in respect of CSR.

Progress in the development and embedding of sustainable development principles over the past five years has now prepared the Group to register as a candidate organisation with the Responsible Jewellery Council. In preparation for certification under the Council, the development of an integrated HSSE audit protocol covering seven international best practice standards related to CSR commenced development in 2012 for implementation during 2013.

Gem Diamonds continues to adhere to the standards of the Kimberley Process and as such, all diamonds produced by the Group are Kimberley Process certified. In addition, all polished diamonds are certified by the Gemological Institute of America (GIA).

Creating a safe and healthy work environment

Gem Diamonds promotes a culture of zero harm and responsible care. The creation of a safe and healthy working environment serves to protect our people, who are key assets of the business. The Company developed and rolled out 'The Gem Way' in 2012, expressing its total commitment to ensuring that each and every task being performed at its operations is carried out in a safe and responsible manner. Gem Diamonds is building a culture of zero tolerance to non-conformance to safe, responsible and sustainable care.

Health and safety management at Gem Diamonds extends beyond mere occupational concerns, and includes providing employees with assistance related to environmental, as well as general serious diseases such as HIV/Aids, diabetes and hypertension, among others. Expansion of this support programme remains on-going.

Appropriate, risk based health and safety management systems are in effect at all the operations and are independently audited annually. This allows for the appropriate allocation of resources to ensure continuous effectiveness and performance improvement – the main goal being to achieve the Group-wide objective of sending each employee home safely to their families.

Given the Company's excellent performance in 2010 and 2011 at the majority of its operations, the year-end performance in 2012 was disappointing. Gem Diamonds is however, proud to report that the Ellendale operation recorded 1 000 days Lost Time Injury Free in May 2012, while Letšeng recorded 13 months Lost Time Injury free in November 2012. Despite these excellent achievements, Gem Diamonds regrettably reports that two of our colleagues at Ghaghoo, Opelo Mmolai and Mogakolodi Monthe, lost their lives in a fall of ground incident, while our colleague, Mateboho S'kosana lost her life at Letšeng when a wall collapsed onto her in a non-mining accident. Our heartfelt condolences go out to their families and loved ones and we would like to express our commitment to ensuring that incidents of this severity will not be tolerated at any of our operations.

A further five Lost Time Injuries were recorded across the Group in 2012, resulting in a Lost Time Injury Frequency Rate of 0.30, which is well in excess of the Group's target of 0.00. Similarly, the Group-wide All Injury Frequency Rate of 4.45 at year-end exceeded the threshold of 4.20.

In 2012, the Company's health and safety focus was on the proactive identification of at-risk behaviours and conditions, which the Company believes will aid greatly in the elimination of injuries and incidents. In 2011 only 1 832 proactive health, safety and environmental reports and actions were recorded, compared to 43 899 in 2012.

Gem Diamonds' goal remains to achieve zero harm in a sustainable manner and the Company will continue to refine and improve its health and safety management systems through on-going identification and implementation of appropriate continuous improvement measures.

For more information in respect of specific keyperformance indicators, refer to the full Sustainable Development Report available on the Company's website www.gemdiamonds.com

Developing and retaining our people

Gem Diamonds' human resource strategy is to engage, develop and retain first-class employees. The development and retention of a skilled and operationally intelligent workforce is regarded as a key element to achieving operational excellence.

At year-end, a total of 480 own and 1 676 contractor employees were employed by Gem Diamonds around the world, where possible, on a permanent basis.

Employee absenteeism rates decreased from an average of 2.11 days per person in 2011, to 1.68 in 2012. Monitoring of staff turnover continues across all operations and a significant decrease in turnover rates was recorded at Ellendale in 2012 as a result of the implementation of improved roster arrangements. Staff turnover at Letšeng in 2012 was 8% while, due to the short term nature of contracts at Ghaghoo, turnover is not yet being recorded.

Employee training remains a priority at all operations and in 2012, a 67% increase in per capita vocational training hours was recorded across the Group, compared to 2011. This training is provided via internal and external training mechanisms. In addition, strong mentoring programmes are in place at the operating mines in order to facilitate adequate skills transfer and career succession. Career reviews continue at all operations, with 30% of all employees across the Group having undergone such reviews in 2012. This is a significant increase from 16% in 2011. Career review and development policies are determined by each subsidiary which prescribe the level of seniority from which reviews are conducted. No differentiation is made between male and female employees' reviews.

Gem Diamonds' Code of Ethics clearly communicates its status as an equal opportunity employer. The Code further outlines the Company's policy regarding zero tolerance towards non-discrimination on any basis and zero cases of discrimination was recorded in 2012. A total of 18% of employees across the Group were female in 2012. Localisation of the workforce is another human resource priority across the Gem Diamonds Group. In 2012 at Letšeng, 90% of the Company's workforce comprised Basotho nationals, at Ghaghoo 89% comprised Motswana nationals and 87% of the KDC workforce was Australian nationals.

Gem Diamonds continues to refine policies, processes and procedures relating to the upholding of the human rights of our employees' and our project affected communities. A total of 300 hours of human rights training was undertaken in 2012 and involved all employees.

Labour relations at all operations remained stable in 2012. None of Gem Diamonds' operations and/or facilities are unionised, although freedom of association remains a core right for each employee. No strikes or lock-outs occurred during 2012.

Gem Diamonds continues to remunerate its employees at or above market related rates and the lowest graded employees are compensated in excess of the host country minimum wage provisions. Relevant benefits and incentives are provided to employees over and above normal salaries, with US$5.2 million spent on such benefits in 2012.

Ghaghoo employees conducting a team building event

Business review
Sustainable Development Report continued

Reducing our resource consumption

The efficient use of resources directly affects Gem Diamonds' bottom line and contributes to the ability of the organisation to adapt to an environment that is increasingly resource-constrained. Therefore, the Company continually implements ways to reduce the consumption of natural capital and thereby contribute to the preservation of precious resources for future generations.

As a diamond mining company, Gem Diamonds is reliant on various natural and non-renewable resources to conduct its business. The Group aims to reduce its resource consumption through process optimisation, recycling initiatives and the introduction of progressive technologies. Reducing dependence on natural resources ensures equitable access to natural resources by local communities and other businesses. The Company has also noted the cost benefit which results from reduced consumption and process optimisation and therefore regards this initiative as beneficial to its business and to the environment in which it operates.

Overall, the Group's energy consumption increased by 21% during 2012 as a result of a year-on-year increase in material moved and processed at the Letšeng and Ellendale operations, and the continued construction of the Ghaghoo mine in Botswana. The implementation of energy efficiency projects remained a focus during 2012 for operations at both Letšeng and Ellendale and these projects remain on target. Energy conservation and efficiency has been a strategic objective for the Ghaghoo mine from the outset. Reduction measures were integrated into the design planning phase of the project and these initiatives continue to deliver the desired results.

Larger mining haul trucks increase fuel efficiency at Ellendale

Energy intensity per carat produced continues to be measured Group-wide and allows the Company to better understand its consumption patterns and opportunities to utilise this resource more efficiently. In 2011, energy intensity per carat recovered increased by 26% and in 2012 by 4% as a result of the higher ratio of waste rock mined at both Letšeng and Ellendale to access diamondiferous ore. At Ellendale major improvements to the processing plant, as well as the introduction of a more effective mining fleet, aided in reducing this operation's energy intensity by 10.5%.

In 2012, raw water consumption for the Group increased by 19% over the previous year, with a total volume of 14.9 million cubic meters of water used across the operations. This is attributed to the increased production rates at the operational mines, the construction of the Tailings Storage Facility 1D Cell 3 at Ellendale, and the construction of the Ghaghoo mine where dewatering ahead of the decline sand tunnel commenced. In addition to major improvements in energy efficiencies resulting from the process plant improvements at Ellendale, achieved 17% decrease in raw water consumption intensity was achieved.

In 2013, Gem Diamonds will continue to seek ways in which to reduce its environmental footprint, including technologies and processes that achieve actual resource reduction.

Minimising our environmental impact

Gem Diamonds' environmental management approach is based on the level of environmental risk exposure and cost reduction. The Company adopts a precautionary approach when considering potential environmental impacts and implements a comprehensive environmental management programme at each of its operations to mitigate actual impacts.

The minimisation, mitigation and management of environmental impacts related to operations, are key elements of the Company's duty of care – a responsibility that Gem Diamonds takes seriously. Across the Group, extensive impact assessment is undertaken in accordance with relevant international best practice standards, prior to commencement of activities and continuously throughout the life of the operations. These assessments inform the management approach at all operations, satisfy regulatory requirements and, importantly, provide assurance to the Company's stakeholders that it is adequately protecting their natural heritage. Environmental impacts resulting from the operations are managed through the implementation of an extensive and dynamic management system.

The Gem Diamonds Group continues to invest in environmental protection. A total of US$3 million was spent on environmental training, expert consultants, research and development, green purchases and other expenditure associated with environmental protection in 2012. This includes AU$0.9 million spent on progressive rehabilitation at Ellendale in 2012.

An increased number of minor incidents were recorded in 2012. This is not regarded to be indicative of inadequate environmental management practices, but rather increased awareness and discipline around the monitoring and reporting of incidents. Three significant environmental incidents occurred at Ellendale, one at Letšeng and one at Ghaghoo.

The continuous development and review of comprehensive rehabilitation plans at Gem Diamonds' mining operations remained a focus during 2012. Excellent progress was made in 2012 to integrate progressive rehabilitation programmes into each operation's mine plans, working towards achieving our mine closure goals in as efficient a manner as possible. In 2012 an additional 112 ha of land within the existing mine lease areas was disturbed, comprising 9.97% of the total land under Gem Diamonds' management. Concurrent rehabilitation was undertaken in 2012 at the Ellendale operation, with approximately 61 ha of land undergoing partial rehabilitation. Letšeng initiated extensive rehabilitation trials in 2012 that will assist in determining the feasibility and success of various planned rehabilitation strategies well in advance of mine closure.

Water pollution sources at the Letšeng and Ellendale operations are minimal. Water quality challenges are mostly limited to elevated suspended solids which may negatively affect the ambient environment if discharged. Prevention, point source treatment and management of elevated levels of Nitrates continue to be investigated at Letšeng and the construction of an artificial wetland to treat effluent water commenced in late 2012. Care is taken at the operations to ensure that any water discharged is of an appropriate quality and discharges only take place when permitted.

Waste generated at Gem Diamonds' operations includes domestic and general waste from on-site accommodation facilities, limited amounts of hazardous waste such as used oils and lubricants, fluorescent tubes, sewage effluent, medical waste and a significant amount of mineral waste. Waste management plans have been developed and are implemented at each of the operations to ensure the correct handling of waste to avoid environmental pollution. Waste separation and recycling is undertaken where possible and 37% of all solid waste generated at the operations was recycled in 2012. Waste materials are disposed of in accordance with approved methods. Point source elimination of waste is also a strategic priority at all operations – an example being the elimination of fluorescent lights at Letšeng, through the installation of non-mercury containing LED based alternative lighting.

Mineral waste generated at all the operations is retained on-site in suitably designed and managed facilities. All mineral waste structures are designed, maintained and managed in compliance with host country legislation and international best practice standards. Mineral waste generation increased at all operations during 2011 and 2012 as a result of waste stripping undertaken at the Letšeng, Ellendale and Ghaghoo operations in accordance with their mine plans.

Great efforts are made to minimise the operations' impact on biodiversity. Gem Diamonds endeavours to limit infrastructure footprints to conserve and protect as much of the naturally occurring fauna and flora as possible. In 2012, Letšeng invested in the development of a Biodiversity Action Plan to address the biodiversity impacts identified during the Social and Environmental Assessment. This plan sets out the actions by which Letšeng can limit, manage and monitor its overall impacts on biodiversity. Ghaghoo continued to implement its environmental management plan to mitigate and manage any impacts on the sensitive ecological systems of the Central Kalahari Game Reserve.

All operations will continue to enforce and monitor adherence to legislative, best practice and site specific environmental management practices and processes. Zero tolerance for major environmental incidents will continue in 2013, while each operation is expected to implement a new practicable environmental optimisation project.

Ellendale process water dams

Thunderstorm brewing over Central Kalahari Game Reserve

Business review
Sustainable Development Report continued

Optimising community benefit

Gem Diamonds operates in existing socio-economic environments and benefits from mining diamonds during the life of the operations. The Company has a moral obligation in turn to contribute to sustainable socio-economic growth of these areas in which it operates. The Group takes seriously its duty of care to maintain open, transparent, respectful and mutually beneficial relations with its neighbours and continues to actively engage with all stakeholders.

Gem Diamonds is pleased to report that zero major stakeholder incidents were reported for the fourth year running and in 2012, no significant incidents were reported.

All the operating mines have culturally appropriate and sustainable Corporate Social Investment programmes in place, based on detailed community needs analysis, in addition to optimising employment from local communities and procurement from local and regional sources. In 2012, Corporate Social Investment expenditure amounted to US$0.6 million. This is a reduction from 2011 and is a result of the conclusion of several major projects that commenced implementation in 2010. The Group continues to focus on projects related to health, education, infrastructure, small and medium enterprises and regional environmental initiatives. US$1.9 million was paid in early 2013 to the Bunuba People's Trust, the Traditional Owners of the land on which Ellendale is located in respect of the Native Title and Compensation Agreement.

At Letšeng, projects that commenced in 2010, reached completion in 2012. The Company is pleased to report that two significant projects, the Wool and Mohair and the Molaroneng eco-tourism lodge, have achieved their goals of improving the lives of the Project Affected Communities in a substantial and sustainable manner. Ellendale continues to make significant contributions to the Healthy Lifestyles programme in the Fitzroy Valley and has launched its support of the Marulu Lilliwan project that assists the community to manage and prevent Foetal Alcohol Syndrome Disease. Ghaghoo has successfully provided much needed potable water to the Mothomelo community and continues to progress the delivery of potable water to other communities in the Central Kalahari Game Reserve.

Since 2009 and as part of the stakeholder engagement with the Project Affected Communities surrounding the Ghaghoo operation, one clear objective from the community stood above all others – the optimisation of local employment. Gem Diamonds is pleased to report that the rotational employment of unskilled labour from the Kaudwane village has resulted in 148 people having worked at the mine, resulting in BWP0.2 million flowing into this largely unemployed community. Several community members are now permanently employed at the operation. An additional BWP1.1 million in salaries have flowed into the Lephepe community.

Ellendale continues to implement the CSI programme to ensure a smooth socio-economic transition for the Project Affected Communities, from relying on the continued support of the operational mine, to the potential closure of the operation. The three year Letšeng CSI investment programme came to an end in 2012 and a new forward-looking plan was established for implementation in 2013 – ensuring that the Project Affected Communities surrounding the Group's flagship operation continue to benefit from sustainable and independent development programmes.

No resettlement of communities was undertaken during 2012 and it is not anticipated to be necessary for any of the existing operations.

Training in sheepshearing skills through the Letšeng wool and mohair project

Ghaghoo community members meeting regarding water supply project

Product integrity

To Gem Diamonds, product integrity demonstrates that the Company has met its responsibilities as an ethical and accountable organisation, that it effectively manages its environmental impacts, provides a healthy and safe working environment and optimises community benefit.

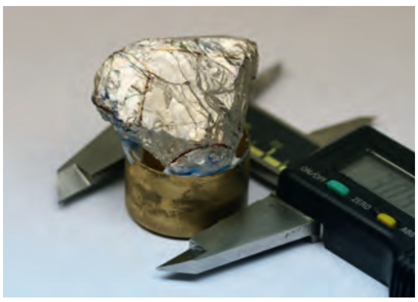
Gem Diamonds is committed to supplying natural diamonds to its clients with assurance of the highest product integrity. In order to achieve this, the Company has cultivated a strong culture of corporate integrity and good governance which extends throughout the full business cycle. To this end, the Company has been building its sustainable development framework progressively since 2009 to ensure continuous improvement in all matters related to the environment, society, human rights, health, safety and security. In 2012, Gem Diamonds registered with the Responsible Jewellery Council as a candidate organisation. The Council promotes responsible and ethical, environmental and social practices as well as the protection of human rights throughout the diamond, gold and platinum group metals jewellery supply chain. Gem Diamonds' business philosophy is consistent with the Council's stated mission and vision and registering as a member will enable rigorous and independent verification of the way the Company lives up to its commitments. Full registration with the council is expected to be concluded in 2014.

Gem Diamonds continues to adhere to all the provisions of the Kimberley Process. All diamonds are certified in terms of the Kimberley Process certification scheme and all polished diamonds are certified by the Gemological Institute of America. All Gem Diamonds' operations undergo independent annual audits conducted by the Kimberley Process team and have remained fully compliant since the company was founded in 2006.

Traditionally, the diamond industry has low levels of transparency necessitated by strict requirements for security and confidentiality. To overcome some of these challenges and to ensure that the Company's diamonds reach the market through the correct channels, strict controls are applied. A screening process is undertaken to identify potential clients and trade with Gem Diamonds is based on invitation. Clients are vetted to ensure that they are compliant with the Group's internal anti-money laundering protocols. Gem Diamonds believes in building relationships based on trust with its clients and other stakeholders. This is achieved through continuous and transparent communication.

Gem Diamonds maintains a high level of transparency and integrity during the marketing and sales process. Inherent to the trade of natural diamonds is the occurrence of natural flaws and inclusions. Gem Diamonds does not provide warranties in respect of its diamonds and diamonds are therefore made available for detailed inspection by clients prior to the conclusion of a sale.

The confidentiality of clients is protected in all instances. The Company enters into confidentiality agreements with its clients and the client list is known to only a handful of people in the sales and marketing team. The outcomes of bids and tenders are also kept confidential.



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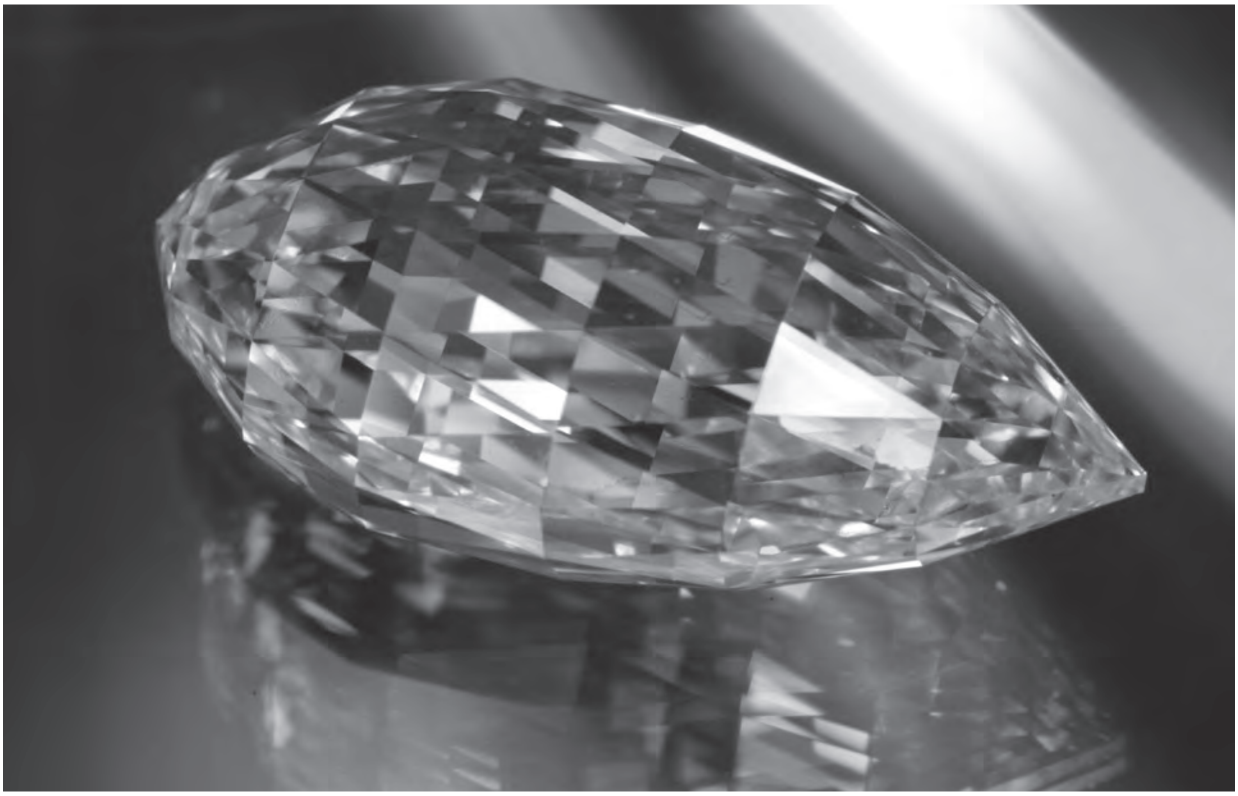


Governance
Chairman's overview of corporate governance

The responsibility for good corporate governance lies with your Board, and the Directors and I regard the setting, maintenance and review of high standards as an essential part of our work. We spend significant time at Board and Committee meetings, and in our discussions with Executive Directors, to ensure there is a strong and effective governance system in place throughout the Group. We monitor trends in corporate governance, adapting practices in order to improve the overall control of our business. I believe this will lead to a more effective Board and also facilitate my leadership role.

Corporate governance is embedded in the way we organize our business, with local Boards and Audit Committees having responsibility for our operations in local markets.

I am pleased to confirm that during the year the Company adhered to the principles of the Code published in June 2010. In respect of provisions, the only exceptions relate to B.2.1 and C.3.1 Committee membership, where we felt that compliance for its own sake would not prove more effective to the management of your Company and the effectiveness of the Committee. This is more fully explained in the following Corporate governance report.

Governance helps us to do the right thing for our shareholders, customers, employees, suppliers, local communities and the environment. Therefore, whilst I am ultimately responsible for the application of the various provisions of the Code, specific responsibility is delegated to individuals whose task it is to ensure adoption. These individuals include the Company Secretary and the Chairmen of the various Committees.

As Chairman of the Board, I am responsible for its leadership and for ensuring its effectiveness. I believe that effective governance is best realised through collaboration. To this end, I expect all Directors, but particularly non-executive Directors, to constructively challenge proposals that come to the Board for decision and to contribute to the development of the strategy. This is one of the criteria I have used in determining the contribution of Directors during the year. As part of our Board evaluation process, we have reviewed the Board's approach to strategy with regard to both process and initiatives. The results of this evaluation were taken into account at our strategy meeting in November 2012. Board evaluation was by way of a questionnaire carried out internally, with the results analysed by an external consultant.

We strive to apply best practice to Corporate Responsibility, Environment Management and Health and Safety, which is closely aligned to employee communications and development. I am pleased to inform you that at this year's Investor Relations awards the Company was nominated for its Sustainable Development Report in the category of "Best communication of Corporate Responsibility in the Annual Report". We were proud to share the platform with much larger companies which have many more years of experience in compiling such reports.

In the following pages you will find overviews of our primary four Committees plus detailed information regarding their operation within the governance framework overall.

Following the implementation of the UK Bribery Act, the Company implemented a review of its policies and procedures and the principles set out in the related Ministry of Justice Guidance. I am confident that we now have a robust system in place throughout the Group, in terms of both policy and procedure.

I would like to take this opportunity to set out our approach to diversity in the boardroom, a topic which has aroused considerable interest in the business community. At present, our Board comprises four Executive Directors and five non-Executive Directors representing different nationalities and disciplines (the detail of which you will find in the biography for each individual). We acknowledge the importance of diversity, including gender, to the effective functioning of your Board and commit to supporting diversity in the boardroom. We value diversity of business skills and experience because Directors with a range of skill sets, capabilities and experience gained from different geographic and cultural backgrounds enhance the Board by bringing a wide range of perspectives to the business. More information about our Board Diversity Policy can be found under the Corporate governance report on page 57.

Looking ahead, we recognise that corporate governance is central to our continuing success and will strive to maintain the high standards that we have set.

Roger Davis
Chairman
11 March 2013

Board of Directors
Non-Executive Directors

Roger Davis (56)
non-Executive Chairman

Roger spent eight years at Barclays, latterly as the CEO of the UK banking operation and as a member of the Board of Barclays Plc. Under his leadership, the UK business was significantly restructured. Prior to that, he spent ten years in investment banking in London and held various positions in China and India for Flemings and BZW. Roger started his career with a 12-year service in the British Army. He joined Gem Diamonds in February 2007. Roger is currently the non-Executive Chairman of Cabot Credit Management Ltd and of GRC Ltd, and is also a non-Executive Director at Experian plc.

Key skills and experience:
Commercial and Capital Markets; Public Company Board Governance

Dave Elzas (46)
non-Executive Director

Dave has over 15 years' experience in international investment banking. Between 1994 and 2000, Dave served as a senior executive and subsequently Managing Director of the Beny Steinmetz Group. Dave is currently the Senior Partner and CEO of the Geneva Management Group, an international wealth management and financial services company and was appointed as a Director of Zanaga Iron Ore Co. Ltd in November 2010. Dave joined Gem Diamonds in October 2005.

Key skills and experience:
Finance; Diamond Industry Trading; Capital Markets

Mike Salamon (57)
Senior Independent Director

Mike is a mining engineer with an MBA and has over 30 years' experience in the mining sector. He was a founding Director of Billiton and was instrumental in Billiton's IPO on the London Stock Exchange in 1997 and the subsequent merger with BHP in 2001. Mike retired from his position of Executive Director at BHP Billiton in 2006. Thereafter Mike was appointed Executive Chairman of New World Resources and led its IPO on the London Stock Exchange in 2008. He retired from this position in 2012 and is a non-Executive Director of Central Rand Gold, Ferrexpo Plc and Minera las Cenizas. Mike joined Gem Diamonds in February 2008.

Key skills and experience:
Operational – Mining, Projects, Health and Safety, Sustainability, Corporate Social Responsibility; Capital Markets

Richard Williams MBE MC (46)
non-Executive Director

Richard spent 20 years in the British Army, latterly as the Commanding Officer of 22 SAS Regiment, during which time he saw service across the Middle East, Latin America and Africa. Richard has an MBA from Cranfield University and a Masters in International Security Studies from King's College, London. Richard is a founding member of Central Asian Resources Ltd, a mining investment company focused on Central Asia, CEO of Afghan Gold and Minerals Company, and a non-Executive Director of Henderson Risk Limited, a UK and Africa based risk management business. Richard joined Gem Diamonds in February 2008.

Key skills and experience:
Security; Capital Markets

Gavin Beevers (63)
non-Executive Director

Gavin was the Director of Operations at De Beers from April 2000 until his retirement in 2004. He had joined De Beers in 1979 and was based in Botswana for 11 years. Thereafter he was appointed Assistant General Manager at De Beers Marine in Cape Town until 1994, whereafter he returned to Botswana as General Manager at the Orapa and Lethlakane Mines. From January 1996 to March 2000, Gavin held the position of Deputy Managing Director of Debswana Diamond Company. Gavin joined Gem Diamonds in February 2007.

Key skills and experience:
Operational – Mining, Health and Safety, Sustainability, Corporate Social Responsibility

Executive Directors

Clifford Elphick (52)
Chief Executive Officer

Clifford joined Anglo American Corporation in 1986 and was seconded to E. Oppenheimer and Son as Harry Oppenheimer's personal assistant in 1988. In 1990, he was appointed Managing Director of E. Oppenheimer and Son, a position he held until leaving in December 2004. During that time, Clifford was also a Director of Central Holdings, Anglo American and DB Investments. Following the privatisation of De Beers in 2000, Clifford served on the De Beers Executive Committee. Clifford formed Gem Diamonds in July 2005. Clifford is also the non-Executive Chairman of Zanaga Iron Ore Co. Limited.

Key skills and experience:
Diamond and Mining Industries; Commercial and Capital Markets

Kevin Burford (54)
Chief Financial Officer

Kevin has 28 years' experience in the mining industry having worked for De Beers and Anglo American between 1985 and 2005, and Xstrata in 2005. Previously he was the Group Manager – Finance at De Beers where he had responsibility for the financial aspects of all De Beers' operations and exploration activities across the globe. In addition he has held strategic leadership positions covering supply chain, IT, risk management, internal audit and business strategy. Kevin completed his articles with Coopers and Lybrand in 1984 and is a registered chartered accountant. Kevin joined Gem Diamonds in January 2006.

Key skills and experience:
Finance; Diamond Industry; Capital Markets

Alan Ashworth (58)
Chief Operating Officer

Alan holds a BSc in Mining Engineering and has 37 years' experience in the mining industry. During his career he has worked in various countries, including South Africa, Namibia, Botswana, Guinea, Ghana, Russia, Indonesia and Australia. He spent 28 years within the De Beers group, including four years as the General Manager of the Namdeb Diamond Corporation and four years as the Group Manager, Operations and Head of Operations for De Beers Consolidated Mines. From January 2006 until August 2007, he was the Managing Director of Gold Fields' Ghana operations in West Africa. Alan joined Gem Diamonds in November 2007 and was appointed to the Board in April 2008.

Key skills and experience:
Operational – Diamond Industry, Mineral Resource Management, Mining (surface and underground), Health and Safety, Sustainability, Corporate Social Responsibility

Glenn Turner (52)
Chief Legal and Commercial Officer

Glenn was called to the Johannesburg Bar in 1987 where he spent 14 years practising as an advocate specialising in general commercial and competition law, and took silk in 2002. Glenn was appointed De Beers' first General Counsel in 2002 and was also a member of the Executive Committee. Glenn was responsible for a number of key initiatives during his tenure, including overseeing De Beers' re-entry into the USA. Glenn joined Gem Diamonds in May 2006 and was appointed to the Board in April 2008.

Key skills and experience:
Diamond Industry; Legal

Focus on value creation
Business review
Governance
Financial statements

UK corporate governance code compliance

This report combines the Directors' report, the Management report and the Company's compliance with the principles and provisions of the Code, and details the key policies, processes and structures that apply to the Company. It also includes sections on the role and work of the Audit, HSSE, Nominations and Remuneration Committees, as required by the Disclosure and Transparency Rules (DTR).

The Company has fully complied with the best practice governance provisions of the Code for the year up to 31 December 2012, with two exceptions, and notes below those periods during the year when it was not fully compliant:

- As previously advised, the position of Lord Renwick on the Audit Committee was taken by Roger Davis on 25 August 2009. As Roger Davis is also Chairman of the Board, this was not in compliance with Section C.3.1 of the Code. This situation will continue for the foreseeable future but will be kept under review. In this regard the Chairman is considered to be independent.
- At the time of Lord Renwick's resignation it was decided that his position on the Nominations Committee would not be filled as the conduct and performance of the Committee was seen to be working effectively with its present membership (Roger Davis, Clifford Elphick and Mike Salamon). The Committee did not believe that filling the vacancy, simply to comply with section B.2.1. of the Code, would improve the effectiveness of the Committee. The situation was last reviewed in November 2012 when it was decided to make no change.

Board of Directors

The role of the Board

The Board is responsible for the overall conduct of the Group's business and has powers and duties pursuant to the relevant jurisdictions in which it is registered and operates.

The Board is:

- responsible for setting the Group strategy and for the management, direction and performance of the business;
- accountable to shareholders for the proper conduct of the business;
- responsible for the long term success of the Company, having regard to the interests of all stakeholders; and
- responsible for ensuring the effectiveness of and reporting on the system of corporate governance.

The Board has a schedule of items for its discussion and decision at each Board meeting:

- the Chairman of each Committee provides a verbal report on its own activities;
- group strategy, new business, and long-term plans;
- operational reviews;
- major capital projects;
- latest financial report;
- annual budget and operating plans;
- group financial structure, including tax and treasury;
- annual and half year financial results and shareholder communications;
- system of internal control and risk management; and
- administrative matters including corporate governance issues.

The Board is responsible to shareholders for the performance and governance of the Company within a framework of policies and controls which provide for effective risk identification, assessment and management. The Board provides leadership and articulates the Company's objectives and strategy to achieve those objectives. The Board sets standards of conduct which provide an ethical framework for all of the Company's business functions. While the Board focuses on strategic issues, financial performance, risk management and critical business issues, it also has a formal schedule of matters that it does not delegate. These reserved matters, which are documented in a comprehensive list of authorisation levels and prior approval requirements for key corporate decisions and actions, are reviewed annually and, if appropriate, updated by the Board. Such matters reserved to the Board include, but are not limited to, approval of budgets and business plans, major capital expenditure, major acquisitions, disposals and bank borrowing and were last reviewed in March 2012.

Whilst all Directors have equal responsibility in law for managing the Company's affairs, it is the role of the executive management to run the business within the parameters laid down by the Board and to produce clear, accurate and timely reports to enable the Board to monitor and assess management's performance. The executive management draws on the expertise and experience which the non-Executive Directors bring from their various business careers.

All Directors are free to express their views and may ask that these be recorded in the minutes where appropriate. The Company maintains at its expense, a Directors and Officers liability insurance policy to provide an indemnity in certain circumstances for the benefit of Directors and other Group personnel. The insurance policy does not provide cover where the Director or Officer has acted fraudulently or dishonestly.

The composition of the Board is as follows. There were no changes during the year:

Name	Titles	Held appointment throughout 2012	Committee Chairman and (number of members)
Executive Board members (4)			
CT Elphick	Chief Executive Officer	◊	
KM Burford	Chief Financial Officer	◊	
AR Ashworth	Chief Operating Officer	◊	
GE Turner	Chief Legal and Commercial Officer	◊	
Non-Executive Board members (5)			
RW Davis	Chairman	◊	Nominations (3)
GA Beevers		◊	Health, Safety, Social and Environment (3)
DJ Elzas		◊	Audit (3)
M Salamon	Senior Independent Director	◊	
RJ Williams		◊	Remuneration (4)

- The non-Executive Directors possess a range of experience and are of a calibre to bring independent judgement to bear on issues of strategy, performance, and resources that are vital to the success of the Company.
- All of the non-Executive Directors are regarded as independent by the Board as defined in the Code (A.3.1), as was the Chairman on his appointment.

Attendance at Board meetings and Committees of the Board

Five scheduled Board meetings were held during 2012. Attendance by Directors at Board and Committee meetings is shown below. All Board meetings were held in the United Kingdom.

There are six formally constituted Committees of the Board, each of which has formal terms of reference. Those for the Audit, Remuneration, HSSE and Nomination Committees can be viewed on the Company's website together with the Matters Reserved for the Board, at www.gemdiamonds.com.

In the event that Board approval is required between Board meetings for such matters as capital expenditure, where approvals come within the threshold determined by the Matters Reserved for the Board, Board members are emailed with the details, including a justification. The decision of each Board member is communicated and recorded at the next following Board meeting.

UK corporate governance code compliance continued

Attendance at Board meetings and Committee meetings during 2012

Number of meetings held	Board	Audit	Remuneration	Nominations	HSSE
Director					
RW Davis	5/5	4/4	4/4	4/4	–
CT Elphick	5/5	–	–	4/4	–
GA Beevers	5/5	–	–	–	4/4
DJ Elzas	5/5	4/4	4/4	–	–
M Salamon	5/5	–	4/4	4/4	4/4
RJ Williams	5/5	4/4	4/4	–	–
AR Ashworth	5/5	–	–	–	–
KM Burford	5/5	–	–	–	–
GE Turner	5/5	–	–	–	4/4

A further Board Committee meeting to approve Group funding matters was held on 27 June 2012 as a result of delegated authority from the Board.

Before each Board meeting the non-Executive Directors meet independently of the Executive Directors, in accordance with a practice adopted by many listed companies. During the year there were four such meetings.

Chairman and Chief Executive

A clear separation is maintained between the responsibilities of the Chairman and the Chief Executive. This separation was established during 2007 with the appointment of Roger Davis as Chairman.

The Chairman is responsible for creating the conditions for the effective working of the Board. The Chief Executive is responsible for the leadership, operations and management of the Company within the strategy and business plan agreed by the Board. Also listed below are the roles of the Senior Independent Director (SID) and non-Executive Directors.

Roles of the Chairman and Chief Executive

The Role of the Chairman – Roger Davis	The Role of the Chief Executive – Clifford Elphick
The effective operation and leadership of the Board, and setting the highest standards of corporate governance.	Developing a business strategy for the company to be approved by the Board on an annual basis.
Providing strategic guidance to the executive team.	Producing business plans for the company to be approved by the Board on an annual basis.
Setting the agenda, style and tone of Board discussions.	Overseeing the management of the executive resource and succession planning processes and presenting annually the output from these to the Board and Nominations Committee.
Through the Nominations Committee, ensuring that the Board comprises individuals with an appropriate mixture of skills, experience and knowledge.	Ensuring that effective business and financial controls and risk management processes are in place across the Company and ensuring compliance with all relevant laws and regulations.
Ensuring that the company maintains effective communication with shareholders and that their views and any concerns are understood by the Board.	Making recommendations to the Board on the appropriate delegation of authority within the Group.
Working with the Chief Executive to ensure that the Board receives accurate and timely information on the performance of the Company.	Keeping the Board informed regularly as to the performance of the Company and bringing promptly to the Board's attention all matters that materially affect, or are capable of materially affecting, the performance of the Company and the achievement of its strategy.
Leading the evaluation of the performance of the Board, its Committees and individual Directors.	Developing for the Board's approval appropriate values and standards to guide all activities undertaken by the Company.
	Providing clear and visible leadership in responsible business conduct.

Roles of the Senior Independent Director and non-Executive Directors

Senior Independent Director – Based in the UK	Non-Executive Directors
Acting as a sounding board for the Chairman.	Scrutinising the performance of management in meeting agreed goals and objectives and monitoring the reporting of performance.
Serving as an intermediary for other Directors if necessary.	Reviewing the integrity of financial information and determining whether internal controls and systems of risk management are robust.
Being available to shareholders if concerns they have raised with the executive team and/or the Chairman have not been satisfactorily resolved.	Determining the Company's broad policy for executive remuneration and the remuneration packages for the Executive Directors and the Chairman through the Remuneration Committee
	Providing a wide range of skills and independence, including independent judgment on issues of strategy, performance and risk management.

Board skills, balance and independence

As a mining company, the sustainability of the day-to-day operations in both the medium and long-term, are of major importance in ensuring the Company's profitable progress in securing continued shareholder value. In addition, security plays a significant role in maintaining the flow of high quality diamonds for which the Letšeng mine is renowned. As the Company has moved into cutting and polishing, employing its unique technology, and as new sales and marketing strategies are being rolled out, a knowledge of the diamond industry is essential in order to foster new business opportunities. Financial resource and capability are also necessary in order to ensure fulfilment of the Company's strategy, both financially and corporately. The biographies, which can be found on pages 50 and 51, provide more information on each Director's competencies and all Directors allocate sufficient time to the company to discharge their responsibilities effectively.

The Company complies with the requirement of the Code that there should be a balance of Executive and non-Executive Directors such that no individual or group can dominate the Board's decision-taking.

Non-Executive Directors should be independent in character and judgment. Of the current five non-Executive Directors, all are considered by the Board to be independent of management.

The letters of appointment of the non-Executive Directors are available for inspection at the place of business of the Company in London.

The Board reviews annually the composition and Chairmanship of its primary Committees, namely the Audit, Remuneration, Nomination and the HSSE Committees.

Appointments and re-elections to the Board (see also Board diversity on page 57)

The Code requires there to be a formal, rigorous and transparent procedure for the appointment of new Directors, which should be made on merit, against objective criteria and with due regard to the benefits of diversity on the Board, including gender (B.2). Since 2007, recruitment to the Board has been on the basis of recommendation, thus no outside consultants have been employed. The 'pool' of appropriately qualified individuals is small and suitable candidates are known to the management. The Nomination Committee's section of this report is set out on page 62 and 63.

Starting in 2012, all Directors retired and, if appropriate, offered themselves for re-election at the Annual General Meeting in accordance with Code provision B.7.1. This practice will be the basis for future re-elections.

Access to independent professional advice and the Company Secretary

All Directors are aware that they may take independent professional advice, at the expense of the Company, in the furtherance of their duties, subject to prior consultation with the Chairman. To date they have not found the need to do so. All Directors have access to management and to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that all governance matters are complied with, and assists with professional development as required.

Arrangements have been approved by the Board to ensure that new Directors should receive a full, formal and tailored induction on joining the Board. In addition, on-going support and resources are provided to Directors in order to enable them to extend and refresh their skills, knowledge and familiarity with the Company. Professional development and training is provided in three complementary ways: regular updating with information on changes (actual or proposed) in laws and regulations affecting the Company or its businesses; arrangements, including site visits, to ensure Directors are familiar with the Company's operations particularly its commitment to and application of the Company's Corporate Social Responsibility

UK corporate governance code compliance continued

policies, which includes health and safety; and opportunities for professional and skills training such as Committee chairmanship and formal professional seminars designed by appropriate advisors.

Following individual Director evaluation, the results are discussed with the individual and, where training and/or development needs are identified, an action plan is agreed.

Performance evaluation

In 2012 a Board evaluation was carried out. This was undertaken by means of a focused questionnaire requiring direct comment, rather than a 'box ticking' approach. The questionnaire was conceived and administered internally by the Chairman and Company Secretary with guidance from an independent organisation, which also has the responsibility for analysing the responses.

In 2012 the evaluation addressed two topics, namely strategy and an individual performance review. The results of the strategic review were circulated to the Board for discussion.

The top strategic issues facing the Company over the next three to five years were identified.

The individual personal evaluations were provided to the Chairman.

In accordance with best practice a Board evaluation will be carried out in 2013, following a similar format to that used in 2012.

The terms of reference and performance of each primary Committee were reviewed with changes made, if appropriate and warranted. These terms of reference were compared to best practice models and there was nothing of significance to change.

The Board has formally reviewed succession plans for Board members, including the Chairman, and key senior executive management roles. This review is regarded as an important feature of the Nomination Committee's function and is carried out at least annually.

Conflicts of interest

The Board maintains a register of 'Conflicts of Interest' which it reviews annually (most recently in November 2012). Should any conflict of interest arise between annual reviews, Directors are on notice to advise the Board and the Board will exercise its authority as appropriate and record such conflicts.

Dealings in shares

The Company has a policy based on the Model Code, published in the Listing Rules, which covers dealings in securities and applies to all Directors, persons discharging managerial responsibilities and employee insiders. This policy was last reviewed in November 2012 and has been circulated to all insiders. The insider list is reviewed routinely.

Remuneration

Whilst the Board is ultimately responsible for Directors' remuneration, the Remuneration Committee, consisting of independent non-Executive Directors, is responsible for determining the remuneration and conditions of employment of Executive Directors and the Chairman. The details of all Directors' remuneration are covered in the Directors' remuneration report on pages 68 to 79.

Bribery act

The Company has implemented a review of its policies and procedures in the light of the Bribery Act and the principles set out in the related Ministry of Justice Guidance. Ernst & Young supported the senior management of the Company in this review. This review was completed in 2012 and a new Group policy was adopted and circulated to staff identified as potentially exposed to bribery and corruption, determined by the company. All of these individuals received formal training during the year.

Board diversity

As encouraged by the Davies Report, the Board supports and welcomes diversity of all types on its Board, including gender diversity. In the event of recruitment, the aim would be to maintain a high level of diversity. Board appointments are based on a spectrum of factors including experience, skills and diversity. Since there has been little movement in the composition of the Board since listing, the Board did not believe any great benefit would be gained in setting gender-based targets at present.

Communication of business development during the year

Detailed information on the Company's business and developments/projects can be found on the Company's website (www.gemdiamonds.com) in the Investors section, where all published information and shareholder communications is available. This includes: IMS; trading updates; year-end and half-year results; analysts' briefing; and all announcements.

Accountability and audit

Financial reporting

The Board is conscious of its responsibility to present a balanced and clear assessment of the Company's position and prospects and the Board is satisfied that it has met this obligation. This assessment is primarily provided in the Business review contained in this report.

The Responsibility Statement of the Directors in respect of the annual report and financial statements is set out on page 85.

Information and financial reporting systems

Financial reporting to the Board is continuously modified and enhanced to cater for changing circumstances. The Company's comprehensive planning and financial reporting procedures include detailed operational budgets for the year ahead and a three-year rolling plan. The Board reviews and approves the annual budget and plan. The plan and budgets are prepared in cooperation with all Group functions on the basis of specified economic assumptions. Performance is monitored and relevant action taken throughout the year through the monthly reporting of key performance indicators and updated forecasts for the year, together with information on the key risk areas.

In addition, routine management reports on an operational and consolidated basis, including updated forecasts for the year, are prepared and presented to the Audit Committee and the Board, and this forms a cornerstone of the system of internal control. Detailed consolidated management accounts, together with an executive summary, are circulated prior to each scheduled Board meeting. Between Board meetings, summary update reports covering matters such as operational performance, sales figures, cash and progress of strategic issues are circulated to the Board members and senior executives.

Internal control

The Board of Directors is responsible for the Company's system of internal control, which is embedded in all key operations. The Board relies on reviews undertaken by the Audit Committee, in accordance with the Company's compliance with the Turnbull Guidance, throughout the year and up to the date of the approval of the Annual Report and Financial Statements. Regular management reporting, providing a balanced assessment of key risks and controls, is an important component of Board assurance.

The Audit Committee reviewed the effectiveness of the system of internal control by considering the regular reports from management on the operation of the risk assessment process throughout the Company. These included the key risks identified, mitigating actions and controls, management representations and assertions, and reports covering the independent assessment of internal control systems from internal audit, together with other assurance providers such as health, safety, social and environmental.

The principal aim of the system of internal control is the management of business risks that are significant to the fulfilment of the Company's business and strategy objectives, with a view to enhancing over time the value of the shareholders' investments and safeguarding the assets. The internal control systems have been designed to manage rather than eliminate the risk of failure; to achieve business objectives; and provide reasonable but not absolute assurance that the Company's business objectives will be achieved within the risk tolerance levels identified by the Board. The Directors confirm that they have reviewed the effectiveness of the system of internal control and have not identified any significant failings or weaknesses.

UK corporate governance code compliance continued

Internal audit

Internal audit is an important element of the overall process by which the Audit Committee and the Board obtains the assurance it requires that risks are being properly identified, managed and controlled. An internal audit function was established in 2007. A risk-based internal audit programme was prepared for 2012 and approved by the Audit Committee, with reports on achievement of the programme and findings presented to the Audit Committee for consideration and approval.

The programme covers all operating units, focusing in particular on the more significant risks and related internal controls identified in the risk self-assessment process. Findings and agreed actions are reported to management and Audit Committee.

The internal audit function is provided by KPMG Services (Proprietary) Ltd as an outsourced service provider.

Risk assessment and management

The Board, through the Audit Committee, considers effective risk management as an essential element of professional management and has implemented risk assessment and control systems across the Group, with the assistance of KPMG Services (Proprietary) Ltd. An on-going process, in accordance with the revised Guidance of the Turnbull Committee on Internal Control published in October 2005, has been established for identifying, evaluating and managing the significant risks faced by the Group. The Group's risk management policy aims to cover and review all significant business risks faced by the Group, including, but not limited to, operational, financial, commercial, legal, regulatory and compliance risks, which could undermine the Company's ability to achieve its strategic and business objectives. These risks are reviewed at least annually. A more comprehensive report of the Group's key risks and the means by which these are managed/mitigated will be found on pages 38 and 39 in the Business review.

The Company's approach to risk management is value driven and has the stated objective of ensuring an environment in which it can grow shareholder value through protecting and enhancing the Group's assets, the environment in those locations in which it operates, its reputation and its staff. The process is thorough and robust and is an essential element of business planning.

Each operating unit carries out a comprehensive annual self-assessment risk review and updates its risk register accordingly. Objectives in the business plan are aligned with risks and a summary of the key risks, related internal controls, accountabilities and further mitigating actions, is reviewed and approved by the Audit Committee/Board for appropriateness and effectiveness.

Progress against plans, significant changes in the business risk profile and actions taken to address controls and mitigate risks are reported at each operating unit board and thereafter to the Group's Audit Committee and as appropriate to the Board.

The results of the process have been reviewed by management with the respective operating units which is then submitted to the Group Audit Committee.

Investment appraisal

Capital expenditure is regulated by a budgetary process and authorisation levels. For expenditure beyond specified levels, detailed written proposals are submitted to the Board. There is an approval procedure for investment appraisal which includes a detailed calculation of return based on assumptions that are consistent with those included in management reports. Reviews are carried out after the project is complete and, for some projects, during the development period of the investment, to monitor progress against plan. All major overruns are investigated. Commercial, legal and financial due-diligence work, using outside consultants as appropriate, is undertaken in respect of acquisitions and disposals.

Whistleblowing programme

There is a formal mechanism to report suspected fraud, corruption and irregularities. There are independently-operated and confidential freephone hotlines in each country in which the Company operates, through which employees can report any breach of the Company's business principles, including but not limited to bribery, breaches of ethics and fraud.

All incidents reported are fully investigated and the results are reported to the local boards and to the Group's Audit Committee. The whistleblowing procedures are reviewed to make sure they are effective and up to date. The process was reviewed in 2012 and each operation was required to reissue literature and contact details to all employees.

External audit

A principle of the Code is that the Board should establish formal and transparent arrangements for considering how it should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the external auditors, Ernst & Young LLP. These responsibilities are delegated to and are discharged by the Audit Committee whose work is described on pages 60 to 62.

Relations with shareholders

Majority interest in shares

On 15 February 2013, the following major interests (at or above 3%) in the issued ordinary shares of the Company had been notified to the Company in accordance with the DTR 5:

Shareholders	Number of ordinary shares	% Shareholding
Graff Diamonds International Ltd	20 906 699	15.12
Lansdowne Partners Ltd	20 721 413	14.99
BlackRock Inc	15 716 051	11.37
FIL Limited/FMR LLC	11 301 546	8.17
Gem Diamonds Holdings Ltd	9 325 000	6.74
Capital Group Companies Inc	8 631 142	6.25

There has been no change reported to the Company since 15 February 2013.

Dialogue with shareholders

The Board places importance on effective communication with shareholders and maintains regular dialogue with and gives briefings to analysts and institutional investors. The responsibility for Investor Relations falls under the responsibility of Glenn Turner, the Chief Legal and Commercial Director based in the Company's London office. Presentations are given by the Executive Directors after the Company's announcement of the year-end and half-year results. Any concerns raised by a shareholder in relation to the Company and its affairs are communicated to the Board as a whole as issues arise and a summary of shareholders' views is presented at each Board meeting.

Care is taken to ensure that any price-sensitive information is released to all shareholders, institutional and private, at the same time, in accordance with the Disclosure and Transparency Rules and with Group policy. This policy was most recently reviewed by the Board in November 2012 and updated as appropriate. It has been circulated to each operation in 2012.

Glenn Turner keeps in contact with the Company's institutional and other shareholders plus industry experts on a regular basis. It is his task to ensure a good flow of reliable information between the Company and its investors.

The shareholder base comprises 138.27 million issued ordinary shares of US$0.01 each. There are 152 institutional shareholders who hold 129.01 million shares (93%) and 484 private shareholders who hold 8.64 million shares (7%)

The Senior Independent Director, Mike Salamon, is available to shareholders if they have concerns which contact through the normal channels has failed to resolve or for which such contact would be inappropriate.

All shareholders can access the Annual and Half-Year Reports; IMSs; Trading Updates; and other published and current information about the Company through the Company's website at www.gemdiamonds.com

Constructive use of the Annual General Meeting (AGM)

The Code urges Boards to use the AGM to communicate with all investors. All Directors attend the AGM, where shareholders are invited to ask questions during the meeting and to meet Directors after the formal proceedings have ended. Shareholders at the meeting will be advised as to the level of proxy votes received, plus percentages for and against in respect of each resolution. The results of the resolutions will be announced through the Regulatory News Service and on the Company's website.

Details of the resolutions to be proposed at the AGM can be found in the Notice of the Meeting. In accordance with the Code, notice of the AGM and related papers will be sent to shareholders a minimum of 20 business days before the meeting which is due to be held on Tuesday 11 June 2013.

Committees
Board Committees

Subject to those matters reserved for its decision, the Board delegates certain responsibilities to a number of primary Committees – the Audit, Remuneration, Nomination and HSSE Committees. The terms of reference of these Committees are available on the Company's website.

The terms of reference of each Committee and its performance were reviewed during the year and, where appropriate, changes were made. The terms of reference for each Committee requires members to be re-nominated every three years (subject to annual re-election). This was undertaken in respect of Roger Davis (Audit and Nominations Committee); Dave Elzas (Remuneration and Audit Committee); Gavin Beevers (HSSE Committee); and Clifford Elphick (Nominations Committee).

Audit Committee

"The Committee has an annual work plan, developed from its terms of reference. This includes standing items that we consider at each meeting, in addition to specific matters arising and items on which we have chosen to focus. In addition, we are evolving our activities in light of guidance from regulators and market conditions".

Dave Elzas, Chairman

The work of the Audit Committee during 2012 is summarised below

Committee members	Member throughout 2012	Number of meetings held / attended 2012
DJ Elzas – Chairman	◊	4/4
RW Davis	◊	4/4
RJ Williams	◊	4/4

The Audit Committee's primary role is: to ensure the integrity of financial reporting and the audit process; and that an appropriate risk management and internal financial control system is maintained. In doing so, the Audit Committee assists the Board of Directors in discharging its responsibilities with regard to financial reporting, external and internal audits and controls. These include but are not limited to: reviewing the annual financial statements and reviewing significant financial reporting judgments; considering the scope of the Company's annual external audit and the extent of non-audit work undertaken by external auditors; approving and monitoring the effectiveness of the internal audit programme and reviewing its findings; advising on the appointment of both internal and external auditors, overseeing this relationship including auditor's remuneration and terms of engagement, monitoring independence, annual review of auditor's performance; and reviewing the effectiveness of the Company's internal financial control and risk management systems.

In accordance with provision C.3.1 of the Code all members of the Audit Committee should be non-Executive Directors, all of whom are independent in character and judgment and free from relationships or circumstances which are likely to affect, or could appear to affect, their judgment. The Audit Committee comprises three non-Executive Directors: Dave Elzas (Chairman of the Committee); Roger Davis; and Richard Williams MBE MC.

Dave Elzas is considered to be independent. The association of Dave Elzas and Geneva Management Group (UK) Limited (GMG) in no way compromises his independence. The fees for the work performed by GMG for the Company are immaterial in relation to the overall income of GMG. With his experience of running several businesses, serving as a member of several Boards (both private and UK listed) and as a partner at GMG, Dave Elzas is regarded as having appropriate financial experience as referred to in provision C.3.1.

Four meetings are scheduled for 2013. The Chief Executive, the Chief Financial Officer and a representative of the Company's internal and external auditors normally attend each meeting. Other Directors of the Company and senior executives may also attend by invitation and speak, but not vote, at any meeting of the Audit Committee.

Audit Committee functions in 2012 included:

Internal controls and risk	External auditors	Financial reporting
Received reports from the external and internal auditors on their assessment of the control environment.	Reviewed reports on audit findings.	Reviewed the half year (2012) and annual financial statements (2011) and the significant financial reporting judgements and the Auditor's report thereon.
Reviewed feedback from the Management reports submitted by managers across the Group, prior to approval of the half year and annual financial statements and before the audit. The Management report covers areas involving significant judgment, estimation or uncertainty, including assessment of fair values, impairment of goodwill, quality of earnings, taxation, treasury, reserves and resources, legal matters and the appropriateness of preparing the financial statements on a going concern basis, which would be assessed.	Considered the independence of the auditors and their effectiveness, taking into account: • non-audit work undertaken by the external auditors and compliance with the policy; • the Committee's own assessment.	Reviewed the trading announcements published in January and June plus the two IMS.
Agreed the internal audit programme, considered the effectiveness of the internal auditors and their reappointment.	Agreed the audit approach and scope of the audit work to be undertaken by the external auditors and the fees for the same.	Reviewed the liquidity risk and the basis for preparing the Group accounts on a going concern basis and reviewed the related disclosures in the annual report.
Examined the effectiveness of the Company's risk management system, including its risk management process and profile, and the Company's internal control systems. The Committee received reports of the internal control environment in place at its subsidiaries which were considered to be effective.	Considered key focus areas for FY2012 audit, including going-concern position, impairments disposal of KDC, Letšeng waste surveying variance and revenue recognition on polished sales.	Reviewed disclosures in the annual report in relation to internal controls, risk management, principal risks and uncertainties and the work of the Committee.
Considered and approved the structure, scope of cover and renewal terms of the Group's insurance programme.	Recommended to the Board the re-appointment of the external auditors following an evaluation of their effectiveness and confirmation of auditor objectivity and independence.	Reviewed management's proposals on impairment.
Reviewed management's assessment of the internal control framework.		Reviewed the appropriateness of the Company's accounting policies.
Assessed the effectiveness of the Group's internal control environment, and approved the statement on the process by which the Committee and the Board review the effectiveness of internal control.		
Reviewed matters reported to the external whistleblowing hotline and a report from the investigations.		
Reviewed and approved the internal audit plans for 2012; the effectiveness of the internal audit function; and the re-appointment of the internal auditor.		
Evaluated the performance of the Committee and its terms of reference.		
The requirements of the Bribery Act in respect of risk and training were addressed and finalised during the year.		

Committees
Board Committees continued

Audit Committee Meetings

Following each Audit Committee meeting, separate meetings were held with each of the following on their own:

- the external auditors;
- internal auditors; and
- the Executive management.

Auditor's independence and non-audit work

The Audit Committee has a formal policy governing the conduct of non-audit work by the external auditors which ensures that the Company is in compliance with the requirements of the Code and the Ethical Standards for Auditors published by the Auditing Practices Board.

The auditors are permitted to provide non-audit services that are not in conflict with auditor independence. Periodic reports are made to the Audit Committee detailing non-audit fees paid to the external auditors.

The fees for such work amounted to US$592 000 in total. This was divided between the continuing operation (excluding Kimberley) of US$421 000 against audit fees of US$1 045 000 representing approximately 40% of audit fees and Kimberley US$171 000 of non-audit fees against audit fees of US$274 000 representing 62%.

The Company is very conscious of ensuring that when commissioning non-audit services there is no conflict which could compromise the auditor's independence. Therefore, as a matter of principle, it only uses services which will be facilitated by the existing relationship with the Company.

Recommendation of auditor

The Committee's assessment of the external auditor's performance and their independence, underpins its recommendation to the Board to propose to shareholders the re-appointment of Ernst & Young LLP as auditors (who were first appointed in 2006) until the conclusion of the AGM in 2013. This assessment includes a review of Ernst & Young's policies for maintaining independence, including the policy for rotation of audit partners. This requires a new lead audit partner to be appointed every five years. In accordance with this policy there was a new lead audit partner appointed in 2011. Resolutions to authorise the Board to re-appoint and determine their remuneration will be proposed at the AGM on Tuesday 11 June 2013.

Nominations Committee

"The Nominations Committee continues its work of ensuring the Board composition is correct and that our governance is effective."

Roger Davis, Chairman

Committee members	Member throughout 2012	Number of meetings held and attendance in 2012
RW Davis – Chairman	◊	4/4
M Salamon	◊	4/4
CT Elphick	◊	4/4

The Nominations Committee comprises two non-Executive Directors and one Executive Director. The terms of reference provide for a formal and transparent procedure for the Committee to follow in discharging its responsibilities. The Committee has responsibility to identify, evaluate and recommend candidates for Board vacancies and to make recommendations on Board composition and balance. Four meetings were held in 2012. All recommendations for Board appointments are made on merit and against objective criteria. In 2012 the Committee has not employed outside consultants as there has been no change to the composition of the Board.

Key objective

- to ensure the Board comprises individuals with the requisite skills, knowledge and experience to ensure that it is effective in discharging its responsibilities.

Responsibilities

The Committee:

- leads the process for identifying and making recommendations to the Board regarding candidates for appointment as directors, giving full consideration to succession planning and the leadership needs of the Group:
- makes recommendations to the Board on the composition of the Nominations Committee and the composition and chairmanship of the Audit and Remuneration Committees;
- regularly reviews and makes recommendations in relation to the structure, size and composition of the Board including its diversity and balance of skills, knowledge and experience and the independence of the non-Executive Directors; and
- oversees the performance evaluation of the Board, its Committees, and individual Directors.

The Board acknowledges that diversity extends beyond the boardroom and supports management in its efforts to build a diverse organization throughout the Group. It endorses the Company's policy to attract and develop a highly qualified and diverse workforce; to ensure that all selection decisions are based on merit and that all recruitment activities are fair and non-discriminatory. The policy acknowledges the importance of diversity, including gender, to the effective functioning of the Board. When recruiting additional Directors and/or filling vacancies which arise when Directors do not seek re-election, the Nominations Committee will seek to appoint new Directors who fit the skills criteria and gender balance that is in line with the Board's aspiration. It continues to focus on encouraging diversity of business skills and experience. Recognising that Directors with diverse skills sets, capabilities and experience gained from different geographic and cultural backgrounds can enhance the Board’s effectiveness. Detail, including the proportion of women in senior management, can be found in the "Developing and retaining our people" section of the Sustainable Development Report 2012.

The Nominations Committee in 2012 deliberated upon:

- succession planning for Directors and senior executives;
- the composition of various Committees;
- reviewing the structure, size and composition of the Board and making recommendations to the Board with regard to any changes required;
- the effectiveness of the Nominations Committee; and
- the composition of the Nominations Committee.

In the year ahead, the Committee will continue to assess what enhancements should be made to the Board's and the Committee’s composition and will continue to monitor developments in corporate governance to ensure the Company remains at the forefront of good governance practices.

Committees
Board Committees continued

HSSE Committee

"The safety and wellbeing of our employees and contractors is our first priority. We drive a culture of 'being our brother's keeper' where each member of our team takes responsibility for their own, as well as each other's safety. We strive continuously to identify potentially hazardous tasks and conditions so that safe working procedures are designed, communicated and embedded by our people themselves at all levels throughout the organisation."

Gavin Beevers, Chairman

Committee members	Member throughout 2012	Number of meetings and attendance 2012
GA Beevers – Chairman	◊	4/4
M Salamon	◊	4/4
GE Turner	◊	4/4

In addition to the formal Committees recommended by the Code, the Board has a Health, Safety, Social and Environment (HSSE) Committee. It assists the Board in developing and monitoring policies and guidelines for management on Corporate Social Responsibility and sustainable development matters, including health, safety, Corporate Social Investment (CSI) and environmental issues. The HSSE Committee's ensures the implementation of these policies and guidelines as well as correct and legal maintenance throughout the Group. Additionally, the HSSE Committee has developed a system of internal controls and risk management policies and procedures which aim to ensure the Group's strategy is cognisant of and takes account the best HSSE practices, the details of which are more fully described in the Sustainability Development Report to be found on pages 40 to 47. The HSSE Committee provides the Board with additional focus and guidance on key global HSSE issues.

The primary purpose of the Committee is to:

- have oversight of and provide advice to the Board and, if necessary, to the Audit Committee, on all HSSE matters within the Group;
- have oversight of and provide advice to the Board on the Group's compliance with applicable legal and regulatory requirements associated with HSSE including recommendations regarding international best practices;
- continually assess the effectiveness of management's approach and effectiveness in managing risks, related to all aspects of HSSE;
- review significant incidents and consider causative factors, consequences and actions including the impact on employees and third parties and reputational risk;
- review the Group's performance indicators in connection with HSSE matters;
- review the Group's external reporting, regulatory and public disclosures on HSSE matters and approve these as necessary;
- report to the Board on developments, trends and/or forthcoming significant legislation on HSSE matters which may be relevant to the Group's operations, its assets or employees ; and
- review the trends and/or forthcoming significant legislation in relation to safety and sustainability which may be relevant to the Group's operation, its assets or employees

More detailed information concerning the Group's sustainability related activities is set out in the full Sustainable Development Report, which can be down loaded from the Company's website: www.gemdiamonds.com

The HSSE Committee in 2012 deliberated on:

Safety	Sustainability	Governance, regulatory and reporting
Received reports from accountable managers on fatalities and all HSSE incidents, including a detailed analysis of factors contributing to an incident and the corrective and preventative measures taken to prevent recurrence	Received reports from accountable managers on all serious HSSE incidents, including a detailed analysis of factors contributing to an incident and the corrective and preventative measures taken to prevent recurrence	Reviewed changes to local and international safety, health and environmental regulations
Reviewed reports on key safety indicators and trends	Reviewed reports on key indicators and trends	Considered feedback from external auditors following their assurance review of selected data in the Annual Report and Sustainable Development Report
Reviewed progress and implementation of strategic plan to improve safety	Reviewed reports on health and community indicators and trends	Reviewed key sustainability related risks and associated mitigation plans
Reviewed effectiveness of disaster contingency plan in providing medical assistance following events in Botswana and approved measures to assure and provide counselling and support to affected employees and their family members	Reviewed reports on implementation of the Group's water management strategy at KDC	Reviewed disclosures in the Annual Report and Sustainable Development Report

Committees
Board Committees continued

Remuneration Committee

"The Committee seeks to set remuneration policies and executive pay packages designed to be competitive and drive achievement of short- and long-term strategic goals."

Richard Williams MBE MC, Chairman

I am pleased to introduce the Directors' remuneration report ("DRR") for the year-ended 31 December 2012. This report was prepared according to the requirements of the Listing Rules (LR-9.8.8) The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, schedule 8.

The Remuneration Committee ('the Committee') aims to ensure that remuneration packages are offered which:

- set the total remuneration package at an appropriate level to reflect the competitive markets in which the Group operates;
- link a substantial proportion of the total remuneration package to the achievement of demanding financial and non-financial performance targets;
- structure the reward of senior management to align their interests with those of shareholders over the long-term;
- enable the retention and stability of the management team; and
- reinforce a high-performance culture throughout the Group.

Towards the end of 2012 the Committee commenced a review of the Employee Share Option Plan ("ESOP"), the Company's long-term incentive plan. Changes are being considered to the ESOP to help ensure the plan is more relevant to participants, more robust to uncontrollable factors, and reflects recent trends in mining sector incentives. Full details of the revised ESOP will be disclosed in next year's DRR.

Draft recommendations published by the Department for Business, Innovation and Skills (BIS) on Executive remuneration reporting have been considered by the Committee. In anticipation of the revised reporting regulations, and in line with evolving best practice, we have provided additional disclosures in this report in advance of being required to do so.

Richard Williams MBE MC, Chairman

Composition of the Committee

The Committee comprises the following members:

Committee members	Member throughout 2012	Number of meetings held / attended 2012
RJ Williams – Chairman	◊	4/4
RW Davis	◊	4/4
DJ Elzas	◊	4/4
M Salamon	◊	4/4

The Chief Executive Officer and the Chief Financial Officer also attend Committee meetings by invitation and assist the Committee in its deliberations, except when issues relating to their own remuneration are discussed. Representatives of Kepler Associates also attend the meeting by invitation.

Role of the Remuneration Committee

The Committee is a formal Committee of the Board. Its Terms of Reference are available on the Company's website and conform to the UK Corporate Governance Code (the 'Code').

The Committee's main responsibilities are to:

- agree policies, determine individual remuneration packages for the Chairman and the Executive Directors, the Company Secretary together with certain senior executives;
- consider and scrutinise all elements of the Company's Executive remuneration policy;
- monitor and recommend the level and structure of remuneration for senior management;
- approve the design of performance-related pay schemes operated by the Company and approve total annual payments;
- review the design of all share-based incentive plans and approve the awards to be made;
- determine the basis for calculating bonuses payable to the Executive Directors;
- make recommendations to the Board on the fees offered to the non-Executive Directors, after taking independent professional advice;
- consider major changes in employee remuneration in the Group; and
- select and appoint consultants to advise the Committee.

The Committee's policy is to encourage an open and transparent dialogue with shareholders on remuneration matters and would seek to consult with major shareholders prior to implementing any significant changes to the senior executive remuneration policy.

Activities of the Committee in 2012

The activities of the Committee are governed by its Terms of Reference which reflect best practice. A review of the Committee's Terms of Reference and the Committee's effectiveness was carried out in March 2012. There were no material issues identified or action arising there from.

During the year, the Committee met four times and it:

- approved the Directors' remuneration report;
- agreed the basis of the award of annual bonuses;
- reviewed share plan performance;
- reviewed and approved awards made under the ESOP;
- approved changes to performance measures and targets of the ESOP applicable to grants made to senior management below Board level;
- reviewed senior executive remuneration in light of developments in best practice and market trends;
- reviewed and approved the base salary and benefits of the Chairman, Executive Directors and Company Secretary;
- set and approved targets for 2012 cash bonuses; and
- reviewed specific incentive plans – particularly relating to the Group's operations associated with projects Kholo and Ghaghoo.

Advisors to the Committee

Kepler Associates, appointed by the Committee in February 2010, provided independent remuneration advice to the Committee and attended Committee meetings during 2012. Kepler Associates provide no other services to the Company.

Directors' remuneration report

External appointments

Apart from private company interests listed in the Prospectus dated 1 April 2009, no Executive Director holds any significant executive directorship or appointments outside the Group with the exception of Clifford Elphick who was appointed non-Executive Chairman of Jumelles Holdings Limited in 2009 and Zanaga Iron Ore Co. Limited which listed on the AIM Market of the London Stock Exchange in November 2010. Total fee paid to Clifford Elphick by Zanaga is £83 000. Dave Elzas was also appointed a non-Executive Director of Zanaga Iron Ore Co. Limited in November 2010. Any fees paid to Clifford Elphick or Dave Elzas in fulfilling these external roles are retained by them.

Executive remuneration policy

The Company's remuneration policy is designed to provide a level of remuneration which attracts, retains and motivates executives of a suitable calibre to execute the Company's business strategy and maximise long-term shareholder wealth.

It is intended that, as far as possible, remuneration policies and practices will conform to best practice in the markets in which the Company operates and will be aligned with shareholder interests and promote effective management of business risk. The Committee takes into account the UK Listing Rules, the principles and provisions of the Code and the guidance provided by institutional investor representative bodies in determining executive remuneration arrangements. In deciding upon the appropriate structure and quantum of remuneration, the Committee reviews remuneration practices at comparator companies, comprising mining companies and UK-listed companies of a similar size and complexity, to ensure remuneration policies reflect, as appropriate, prevailing industry and market conditions. Furthermore, remuneration policies have taken, and will continue to take account of pay and employment conditions elsewhere in the Company.

Elements of Executive Directors' remuneration

The remuneration policy is supported by the following principles:

Elements	Purpose and link to strategy	Policy	Operation
Base salary	• Support recruitment and retention	• Targeted at and above the median of the relevant market • Reviewed annually with adjustments effective 1 April • Salary levels/increases take account of: a. Scope and responsibility of position b. Individual performance and experience c. Market pay levels d. Average increases awarded across the Group	• 2012 salary increases were 4% for Executive Directors • No salary increases have been awarded to the Executive Directors in 2013
Pensions and other benefits	• Provide competitive pension and benefits provision	• Executive Directors receive a cash allowance in lieu of other non-cash benefits • No formal pension provision is made by the Company. Instead, Executive Directors receive a cash allowance in lieu of pension	• As from 1 April 2012 the values of benefits paid to the Executive Directors ranged between 5.5% and 6% of base salary • As from 1 April 2012 cash allowances in lieu of pension were equivalent to 14.5% and 13.0% of base salary for the CEO and other Executive Directors respectively

Elements	Purpose and link to strategy	Policy	Operation
Annual bonus	• Encourage and reward the attainment of challenging financial; strategic; and short term operational objectives	• Award opportunities of up to 100% of base salary for the Executive Directors • 80% is linked to explicit business targets detailed in the Group's Business Plan and encapsulated in specific KPIs • 20% is linked to a discretionary assessment of personal performance • Payouts are subject to Remuneration Committee discretion • A significant proportion of total remuneration should be 'at risk' and conditional on the performance of the Group	• The structure of the bonus for 2012 is detailed on page 71
Employee Share Option Plan	• Reinforces the delivery of absolute and relative returns to shareholders • Provides alignment with shareholders • Attracts executives of the appropriate calibre	• Annual awards of performance shares and/or options • Awards are normally made annually after the announcement of the full year results but may be made at other times deemed appropriate by the Remuneration Committee • Annual maximum opportunity of up to 100% of salary in performance shares and 200% in market value options (subject to overall maximum with fair value equivalent to 100% of salary in performance shares) • Shares vest on Gem Diamonds' three-year TSR outperformance of the FTSE 250 index (xIT) (50% of award) and a peer group of global diamond mining and exploration companies the details of which are on page 74 (50% of award) • Vesting is also dependent on the Remuneration Committee's assessment of underlying performance	• 2012 ESOP awards granted to the Executive Directors comprise c.32% of salary in performance shares and c.63% of salary in options, in face value terms • Towards the end of 2012 the Committee commenced a review of the ESOP, with the objective of considering changes to the structure in 2013 to help ensure the plan is more relevant to participants, more robust to uncontrollable factors, and reflects recent trends in mining sector incentives. Full details of any revisions to the ESOP will be disclosed in next year's Directors' remuneration report

Directors' remuneration report continued

Total of Directors' remuneration

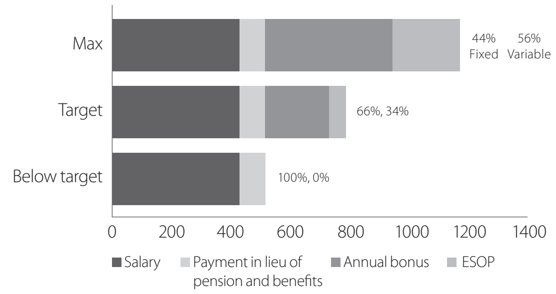
The table below provides a summary of aggregate salaries, benefits and fees paid to Directors.

	2012 £'s	2011 £'s	% change
Basic salaries	**1 307 147**	1 259 824	**3.8**
Benefits	**76 307**	73 544	**3.8**
Annual bonuses	**174 449**	925 797	**(81.2)**
Pension contribution equivalent	**174 708**	163 613	**6.8**
Fees	**307 500**	300 000	**2.5**
Total	**2 040 111**	2 722 778	**(25.1)**
Total Group base salaries, benefits and bonuses	**28 113 370**	24 637 731	**14.1**

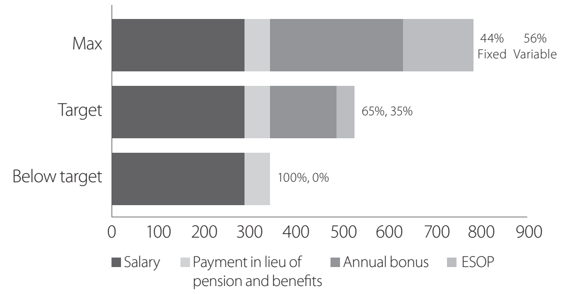
Executive Director pay mix

The pay structure has been developed to be significantly performance-oriented; at target performance c.35% of Executive Director total remuneration is performance-based rising to c.56% at 'maximum' performance.

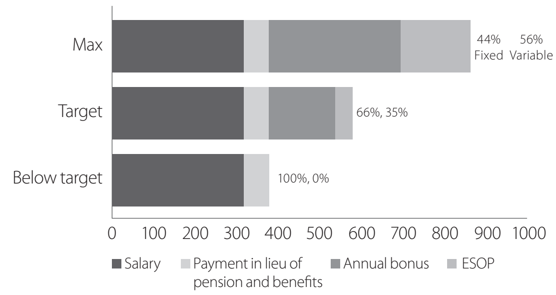
Clifford Elphick, Chief Executive
(£'000s)



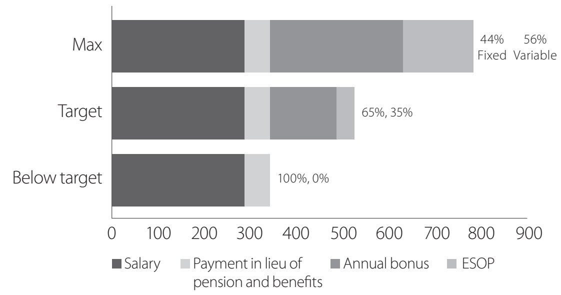
Kevin Burford, Chief Financial Officer
(£'000s)



Alan Ashworth, Chief Operating Officer
(£'000s)



Glenn Turner, Chief Legal & Commercial Officer
(£'000s)



'Below target' performance assumes nil payout under all incentives. 'Target' performance assumes: bonus payout of 50% of salary, ESOP awards vesting at 25%. 'Max' performance assumes: bonus payout of 100% of salary, ESOP awards vesting at 100%. ESOP option awards, where relevant are valued assuming a Black-Scholes value of 33%. No share price growth is assumed in the valuations.

Base salary

Base salaries are reviewed annually with any changes normally taking effect from 1 April. This review takes into account individual performance, experience and market competitiveness. In assessing market competitiveness, the Committee benchmarks salaries against comparable roles at mining companies and UK-listed companies of similar size. In approving Executive Directors' salary increases, the Committee takes into account general pay conditions across the Group.
The Committee reviewed base salaries in March 2013 and agreed no increase for 1 April 2013.

Executive Directors	2012 salary £	2013 salary £	% increase
C T Elphick	428 480	428 480	Nil
A R Ashworth	317 280	317 280	Nil
K M Burford	287 040	287 040	Nil
G E Turner	287 040	287 040	Nil

Pensions and other benefits

No formal pension provision is made by the Company. Instead, Executive Directors receive a cash allowance in lieu of pension which in 2012 was equivalent to 14.5% and 13.0% of base salary for the Chief Executive Officer and other Executive Directors respectively. Executive Directors receive a cash allowance in lieu of other non-cash benefits, the value of which ranged between 5.5% and 6% of base salary during 2012. There are no changes to these allowances for 2013.

Annual bonus

Executive Directors and senior executives participate in a discretionary annual bonus arrangement designed to focus participants on the following business-critical factors (i) growth strategy implementation; (ii) funding; (iii) financial and operational performance; (iv) health, safety and environment, sustainability, image and relationships; (v) sales, marketing and manufacturing, all of which are underpinned by specific Key Performance Indicators and which are included in the Business plan approved by the Board at the beginning of each year. The maximum bonus payable is 100% of base salary, with 80% linked to a business scorecard and 20% linked to a discretionary assessment of personal performance. Details of the business scorecard split used for 2012 are shown in the table below.

Performance category	Performance achievement				
	Weighting	Below threshold	Between threshold and target	Between target and stretch	Above stretch
Growth strategy implementation	30%			◊	
Funding	15%			◊	
Financial and operational performance	30%		◊		
HSE/sustainability/image and relationships	15%		◊		
Sales, marketing and manufacturing	10%			◊	

Directors' remuneration report continued

Whilst the achievement of the 2012 scorecard objectives was strong, in light of the overall financial performance of the Company in 2012 which was primarily affected by poor market conditions, the Committee determined that no bonus be earned in relation to the business scorecard and that bonuses be earned solely based on the achievement of personal objectives set for the executive directors. The Committee approved the following bonuses for 2012:

Directors	Percentage of salary	Bonus
CT Elphick	13%	£55 702
AR Ashworth	13%	£41 246
KM Burford	12%	£34 445
GE Turner	15%	£43 056

The bonus structure for 2013 will be largely consistent with that for 2012.

Employee Share Option Plan (ESOP)

The ESOP was first introduced in 2007, and was subject to several changes in 2010.

The ESOP provides for annual grants of performance shares and fair market value options, the relative proportions of which are determined by the Committee on the occasion of each grant.

ESOP awards may be up to 100% of salary in performance shares, or up to 200% of salary in options, or a mix of performance shares and options subject to the condition that in any one year the combined fair value of the share and option grant is no more than the fair value of an award of 100% of salary fair value in performance shares. 2012 ESOP awards granted to the Executive Directors comprised c.32% of salary in performance shares and c.63% of salary in options, in face value.

Vesting of ESOP awards is subject to the achievement of challenging performance conditions based on the Company's three-year relative Total Shareholder Return (TSR).

TSR performance is measured relative to two comparator groups as follows:

- 50% vests according to performance relative to a peer group of global diamond mining and exploration companies; and
- 50% of the award vests according to performance relative to the FTSE 250 Index (excluding Investment Trusts).

The constituents of the diamond-sector peer group are regularly reviewed by the Committee and adjusted if warranted by corporate actions amongst the constituents. The comparators for the 2010, 2011 and 2012 cycles are as follows:

Company	2010 grant	2011 grant	2012 grant
Lucara Diamond Corp	[1]	[1]	◊
Shore Gold Inc	◊	◊	◊
Petra Diamonds Limited	◊	◊	◊
Namakwa Diamonds Limited	◊	◊	◊
Mountain Province Diamonds Limited	◊	◊	◊
Rockwell Diamonds Inc	◊	◊	◊
Trans Hex Group Limited	◊	◊	◊
Vaaldiam Resources Limited	◊	◊	[2]

1 Africa Diamonds Limited was taken over by Lucara in December 2010. Lucara replaced African Diamonds Limited for the 2012 grant.

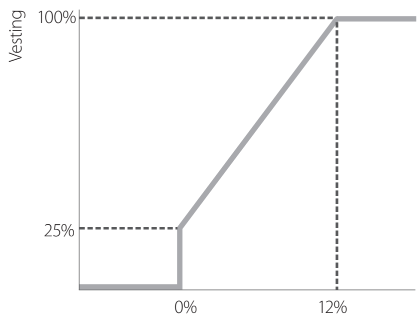
2 Taken over by BCKP Ltd on 6 July 2012 and will not be substituted.

The Committee believes an element based on a broad market index helps provide robustness in light of the small number of companies in the diamond mining comparator group and uses the FTSE 250 as it captures companies with whom Gem Diamonds competes for capital. The Committee considers TSR relative to a global diamond mining peer group to be an appropriate performance measure given the extent to which the Company's share price and those of its peers are significantly influenced by diamond prices.

ESOP awards vest (at 25%) only if the Company's 3-year TSR is in line with average (or benchmark) performance, with full vesting if Gem Diamonds' TSR exceeds that of its benchmark by 12% per annum, which the Committee believes is broadly equivalent to upper quartile performance. There is straight line pro rata vesting for performance between Benchmark and Benchmark +12% per annum.

'Benchmark' performance is based on the published FTSE 250 excluding Investment Trusts index (for that element of ESOP awards) and the average TSR of the diamond mining and exploration companies, weighted by their market capitalisation at the start of the three-year performance period (for the other 50% of ESOP awards). Weighting diamond-mining comparator TSRs by their market capitalisation helps reduce the sensitivity of ESOP outcomes to the smaller comparator companies in the group which are likely to have more volatile TSRs than the Company. A summary of the vesting schedule is provided in the graph below:

Annualised outperformance of benchmark TSR



Additionally, for any ESOP awards to vest, the Committee must satisfy itself that the recorded TSR is a fair reflection of the underlying business performance of the Company over the performance period. In the event that the TSR calculation is affected by a significant corporate event which the Committee considers materially distorts the performance comparison, the Committee may make suitable adjustments, provided that it is satisfied that any new or varied performance conditions would be no less demanding. The Committee may also adopt different performance conditions during the life of the ESOP and may vary the ratio of performance shares and options.

Participation in the ESOP includes the Executive Directors and extends to other senior executives in the Group. Historically, awards granted to the executives below the Board have been entirely consistent in structure with those granted to the Executive Directors. During 2012, the Committee reviewed the effectiveness of TSR-based awards to executives below the Board and approved an award with performance conditions based on specific company objectives. Such grants were made over performance shares and market value options, with vesting based on performance targets for each financial year during the 3-year performance cycle. ESOP awards granted during 2012 to the Executive Directors continued to be based on the relative TSR conditions as described above.

Dividends accrue on performance shares (but not options) during the vesting period. In the event of a change of control, awards would vest according to performance up to the date of the change of control. In addition, share-based, but not option-based, awards would be pro-rated for time based on the proportion of the vesting period elapsed at the date of the event, with Committee discretion to treat otherwise.

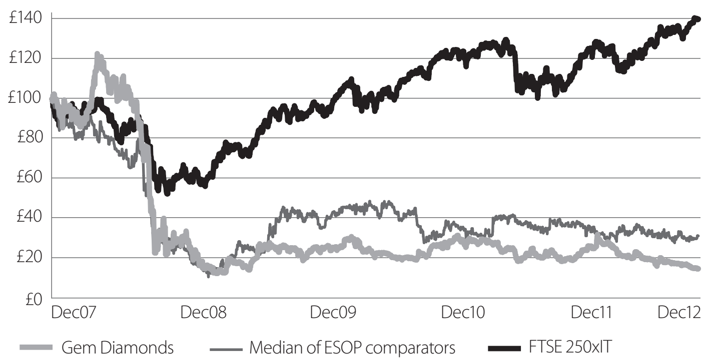
Towards the end of 2012 the Committee commenced a review of the ESOP, with the objective of considering changes to the structure in 2013 to help ensure the plan is more relevant to participants, more robust to uncontrollable factors, and reflects recent trends in mining sector incentives. Full details of any revisions to the ESOP will be disclosed in next year's Directors' remuneration report.

Directors' remuneration report continued

Dilution

ESOP awards may be satisfied with newly issued shares subject to aggregate dilution limits. The issue of shares to satisfy awards under the Company's share schemes will not exceed 10% of the Company's issued ordinary share capital in any rolling ten-year period. As of 31 December 2012, 4 501 200 shares (3.26% of issued share capital) have been, or may be issued, pursuant to all awards made over the last ten years.

Value of £100 invested on 1 January 2008
Gem Diamonds vs. ESOP global mining and exploration comparison and FTSE 250 xIT index



The following information is subject to audit

Executive Directors

Executive Directors' entitlements under service contracts

The details of service contracts and appointment letters are as follows:

The Executive Directors' service contracts

Directors	Contract date	Unexpired term	Notice period	Contractual termination payment
CT Elphick	13 February 2007	rolling contract	6 months (12 months)[1]	Pay salary and benefits on summary termination
KM Burford	13 February 2007	rolling contract	6 months (12 months)[1]	
GE Turner	1 July 2008	rolling contract	6 months (12 months)[1]	
AR Ashworth	1 March 2008	rolling contract	6 months (12 months)[1]	

[1] At the Remuneration Committee meeting held on 4 March 2013 and after having reviewed market practice of FTSE-listed companies and other companies in the mining sector, the Committee approved the extension of the notice periods for the executive directors to 12 months (both from the Company and from the director). This revision will take effect as of 1 March 2013.

There are no special provisions in the contracts extending notice period on a change of control or other corporate event.

Non-Executive directors

The Chairman and Executive Directors approve the fees of the non-Executive Directors. The Committee approves the fees of the Chairman. The fees for non-Executive Directors are set at the level considered necessary to obtain the services of individuals with the relevant skills and experience to bring added depth and breadth to the composition of the Board. Fees take into account the number of meetings, the time required for reading Board and other papers, the duties associated with membership or chairmanship of Board Committees and fees paid by comparable companies.

Non-Executive Director fee structure

Chairman fee	£100 00
Non-Executive Director fee	£52 500

Fees were reviewed in March 2012 when it was approved to increase the Chairman's fee to £100,000 (from £90,000). Fees were also reviewed in March 2013 when it was agreed no changes would be made at this time.

The non-Executive Directors are not eligible to participate in the annual bonus, ESOP, or any other performance related incentive.

The appointment of non-Executive Directors, who do not have service contracts, is on a rolling contract basis. Since the Board has adopted provision B.7.1 of the Code, all Directors will retire annually at the Annual General Meeting and, if eligible, will offer themselves for re-election.

Non-Executive Directors' appointment terms:

Directors	Contract date	Unexpired term	Notice period	Contractual termination payment
RW Davis	1 February 2007	rolling appointment	3 months	No provision for payment of compensation
DJ Elzas	1 February 2007	rolling appointment	3 months	
GA Beevers	1 February 2007	rolling appointment	3 months	
M Salmon	3 February 2008	rolling appointment	3 months	
RJ Williams	3 February 2008	rolling appointment	3 months	

Directors' remuneration report continued

Emoluments and compensation

Details of the remuneration settled in cash or at cash cost to the Company of each Director who has served in the year are shown below. The following table and accompanying notes have been audited.

Details of the Directors' remuneration:

	Salary and fees[1] £	Cash payments in lieu of pension and other non-cash benefits[2] £	Bonuses[3] £	**Total 2012[4]**	Full year Total 2011
Executive					
CT Elphick[5]	424 360	84 357	55 702	**564 419**	797 755
AR Ashworth	314 227	59 322	41 246	**414 795**	575 467
KM Burford	284 280	53 668	34 445	**372 393**	520 638
GE Turner	284 280	53 668	43 056	**381 004**	528 918
Non-Executive					
RW Davis	97 500				90 000
GA Beevers	52 500				52 500
DJ Elzas	52 500				52 500
M Salamon	52 500				52 500
RJ Williams	52 500				52 500

[1] All salaries and fees are paid in cash.
[2] Payments are made in cash to Directors who may purchase benefits.
[3] Bonuses are in respect of 2012 and were paid in 2013.
[4] The Directors' total emoluments for the year do not include any fair value share option/award charges.
[5] Highest paid Director.
[6] No Director received or is due to receive any compensation for loss of office during the year.
[7] Although the Company's reporting currency is US dollars, these figures are stated in Sterling as the Directors' emoluments are paid in this currency.
[8] No Director received any expense allowances.
[9] There were no payments to former Directors of the Company.

Entitlements under long-term incentives

During the year under review, outstanding ESOP awards included those granted in 2010, 2011 and 2012 (there were no long term incentives awarded to Directors during 2009). In respect of performance shares nothing is payable on grant and no exercise price is payable to acquire the shares underlying these awards (save for nominal value where shares are newly issued).

2010 ESOP awards vest 50% on the Company's three-year TSR rank relative to the FTSE 250 and 50% on the Company's three-year TSR rank relative to the diamond mining comparator group; there is nil vesting below median, 25% vesting at median, rising on a straight line basis to full vesting from upper quartile. In 2013, the Committee reviewed the Company's TSR performance over the 2010 ESOP performance period with the result that no 2010 ESOP awards vested.

Details of awards to Directors under the ESOP

Directors	Performance shares* as at 1 January 2012	Exercised in the year	Granted in the year	Lapsed in the year	Exercise Price US$	Market value at date of grant £	Date of grant	Earliest normal exercise date	Expiry date	Performance shares at 31 December 2012
CT Elphick	57 000				0.01	131 670	23 June 2010	23 June 2013	23 June 2020	57 000
	50 000				0.01	131 700	13 June 2011	13 June 2014	13 June 2021	50 000
			45 000		0.01	135 023	20 March 2012	20 March 2015	20 March 2022	45 000
Total										**152 000**
AR Ashworth	42 600				0.01	98 406	23 June 2010	23 June 2013	23 June 2020	42 600
	34 000				0.01	89 556	13 June 2011	13 June 2014	13 June 2021	34 000
			34 000		0.01	102 017	20 March 2012	20 March 2015	20 March 2022	34 000
Total										**110 600**
KM Burford	38 600				0.01	89 166	23 June 2010	23 June 2013	23 June 2020	38 600
	30 333				0.01	79 897	13 June 2011	13 June 2014	13 June 2021	30 333
			30 000		0.01	90 015	20 March 2012	20 March 2015	20 March 2022	30 000
Total										**98 933**
GE Turner	38 600				0.01	89 166	23 June 2010	23 June 2013	23 June 2020	38 600
	30 333				0.01	79 897	13 June 2011	13 June 2014	13 June 2021	30 333
			30 000		0.01	90 015	20 March 2012	20 March 2015	20 March 2022	30 000
Total										**98 933**

*conditional right to acquire shares.

Directors' remuneration report continued

ESOP awards of options

Directors	Performance shares* as at 1 January 2012	Exercised in the year	Granted in the year	Lapsed in the year	Exercise Price GB pence	Date of Grant	Earliest normal exercise date	Expiry date	Performance shares at 31 December 2012
CT Elphick	114 000				231.00	23 June 2010	23 June 2013	23 June 2020	114 000
	100 000				263.40	13 June 2011	13 June 2014	13 June 2021	100 000
			90 000		300.05	20 March 2012	20 March 2015	20 March 2022	90 000
Total									**304 000**
AR Ashworth	85 200				231.00	23 June 2010	23 June 2013	23 June 2020	85 200
	68 000				263.40	13 June 2011	13 June 2014	13 June 2021	68 000
			68 000		300.05	20 March 2012	20 March 2015	20 March 2022	68 000
Total									**221 200**
KM Burford	77 200				231.00	23 June 2010	23 June 2013	23 June 2020	77 200
	60 667				263.40	13 June 2011	13 June 2014	13 June 2021	60 667
			60 000		300.05	20 March 2012	20 March 2015	20 March 2022	60 000
Total									**197 867**
GE Turner	77 200				231.00	23 June 2010	23 June 2013	23 June 2020	77 200
	60 667				263.40	13 June 2011	13 June 2014	13 June 2021	60 667
			60 000		300.05	20 March 2012	20 March 2015	20 March 2022	60 000
Total									**197 867**

* Option is a right to acquire shares granted under the plan including, unless indicated otherwise, a nil-cost option. The market price of an ordinary share at the yearend was 144 pence. The highest and lowest prices in the year were 310.60 pence and 142.75 pence respectively

Details of the vesting conditions, which are subject to audit, for awards made under the ESOP are included on pages 72 to 73 of the Annual Report and a full set of the rules will be available for inspection at the AGM.

Directors' shareholdings and interests in shares

Details of interests in the share capital of the Company of those Directors in office as at 31 December 2012 are given below. It is confirmed that there were no changes to the Directors' holdings between 31 December 2012 and up to the date of this report. No Director was interested in the shares of any subsidiary company.

In addition to these interests in shares, the Executive Directors, along with other employees, also have conditional rights to acquire shares under the Company's long-term incentive plan, disclosed in Note 20.

Executives

	Shares owned outright at 31 December 2012	Nil-cost options and awards held		Options and awards held		Total shareholding
		Subject to performance conditions	Vested but not exercised	Subject to performance conditions	Vested but not exercised	
CT Elphick[1]	9 325 000	456 000	NIL	NIL	NIL	9 781 000
AR Ashworth	21 900	331 800	NIL	NIL	NIL	353 700
KM Burford	458 333	296 800	NIL	NIL	NIL	755 133
GE Turner	400 000	296 800	NIL	NIL	NIL	696 800

[1] Clifford Elphick is interested in these ordinary shares by virtue of his interest as a potential beneficiary in a discretionary trust, which has an indirect interest in those ordinary shares.

[2] There has been no change in these figures since the end of the year and date of the notice of the AGM.

Non-Executives

	Number of shares as at 31 December 2012[3] held in own right
RW Davis	1 267 752
GA Beevers	145 164
DJ Elzas	144 664
M Salamon	316 944
RJ Williams	164 664

[3] There has been no change in these figures since the end of the year and date of the notice of the AGM.

Pensions

No pension contributions were made to any registered pension scheme or pension fund in respect of Executive Directors during the year, and no retirement benefits were paid.

By order of the Board

Richard Williams
Chairman, Remuneration Committee

Director's report

The Directors have pleasure in submitting the financial statements of the Group for the year-ended 31 December 2012. For the purpose of DTR 4.1.8R this report will be deemed the 'Management Report' plus any cross-references made herein and should be read with the Annual Financial Statements on pages 85 to 142.

Principal activities

The Company is a global diamond mining company, listed on the premium market of the London Stock Exchange. More detailed information on the Group's operations, activities and financial performance is incorporated into this report by reference and can be found in the Business review on pages 16 to 47.

Review of the business, future developments and post balance sheet events

As a BVI registered company, Gem Diamonds Ltd is not required to comply with the Companies Act 2006. However the Directors have voluntarily elected to conform to Section 417 of the Companies Act 2006, which requires that the Directors present a Business review in this report to inform shareholders of the Company and help them assess how the Directors have performed their duty to promote the success of the Company. Information that fulfils this requirement can be found in the sections set out below and is incorporated by reference in this report:

Focus on value creation

- Financial and operational performance Inside front cover
- Gem Diamonds at a glance pages 2 to 3
- Business model page 4
- Chairman's statement pages 6 to 9
- Our strategy pages 10 to 11
- Key performance indicators pages 12 to 13
- Our market place and performance page 14 to 15;

The Business review on pages 16 to 47 covers

- Chief Executive Officer's overview pages 16 to 17
- Mining operating reviews pages 18 to 29
- Gem Diamonds marketing and manufacturing review page 30
- Other assets page 31
- Group financial performance pages 32 to 35
- Mineral resources management pages 36 to 37
- Principal risks pages 38 to 39
- Sustainable development report pages 40 to 47

The Business review has been prepared to provide the Company's shareholders with a fair review of the business of the Company and a description of the principal risks and uncertainties facing it. It may not be relied upon by anyone, including the Company's shareholders, for any other purpose.

The Business review and other sections of this report contain forward-looking statements. By their nature, forward-looking statements involve a number of risks, uncertainties and future assumptions because they relate to events and/or depend on circumstances that may or may not occur in the future and could cause actual results and outcomes to differ materially from those expressed or implied by the forward-looking statements. No assurance can be given that the forward-looking statements in the Business review will be realised. Statements about the Directors' expectations, beliefs, hopes, plans, intentions and strategies are inherently subject to change and they are based on expectations and assumptions as to future events, circumstances and other factors which are in some cases outside the Company's control. The information contained in the Business review has been prepared on the basis of the knowledge and information available to Directors at the date of its preparation and the Company does not undertake any obligation to update or revise this Business review during the financial year ahead. It is believed that the expectations set out in these forward-looking statements are reasonable but they may be affected by a wide range of variables which could cause actual results or trends to differ materially. In particular, the forward-looking statements should be read in the context of the specific risk factors affecting the Company identified in the Business review. The Company's shareholders are cautioned not to place undue reliance on the forward-looking statements. Shareholders should note that the Business review has not been audited or otherwise independently verified.

Acquisitions together with disposals, and changes to companies undertaken during the year, (such as they were) including post balance sheet events, of which there was one, are included in the Business review on pages 16 to 48.

Related party transaction

Other than those disclosed in Note 26 of the Financial Statements, the Company did not have any transactions, with and did not make loans to, related parties in the period in which any Director is or was interested.

Exploration and resource development

Resource development activities were concentrated on our two production operations, Letšeng and Ellendale. At Letšeng a comprehensive resource drilling programme was completed in 2012, together with on-going production bulk sampling of the orebody. The drilling programme was successful in improving resource definition and extending kimberlite resources at depth. Activities at Ellendale were restricted to production bulk sampling in the main E9 orebody together with bulk sampling of a satellite lamproite – E11. No exploration activities are currently being pursued by the Group.

Results and dividends

The Group's attributable loss after taxation amounted to US$117.9 million (2011: attributable profit after tax US$67.7 million)

The Group's detailed financial results are set out in the Financial Statements section on pages 85 to 142.

The current focus of the Group is on internal growth and surplus cash is invested into its capital projects, thus the Board recommends that no dividend be declared, in accordance with its intention as set out previously. The Board keeps the Company's dividend policy under review. The factors which are most likely to influence a change in its current policy will be the Company's financial and cash position. Other factors may also have a bearing and these will be taken into account at the time of consideration.

Financial risk management

The Group's key risks are detailed on page 38 and 39 of the Business review.

Corporate social responsibility and sustainability

A review of health, safety, corporate social responsibility and environmental performance and community participation is presented in the Sustainable Development Report on pages 40 to 47.

Greenhouse gas emissions

The total carbon footprint for the Group in 2012 was 166 807.5 tonnes CO_2e. This figure includes the direct GHG emissions (Scope 1) and energy indirect GHG emissions (Scope 2).

In 2012, we reviewed and recalculated the Group's carbon footprint, with boundaries clearly defined as per guidance from the GHG Protocol: A Corporate Accounting and Reporting Standard and in line with the ISO14064 standard. We adopted a more thorough process for this year's data collection which yielded a more complete and subsequent larger absolute carbon footprint for 2012. For this reason the 2012 footprint has been set as the new baseline and the starting point for tracking of the Group's carbon footprint.

We believe that the various energy reducing and energy efficiency measures that were implemented in the past year across all our operations made a positive contribution to reducing our carbon footprint. However, the impact of these measures could not be established due to the newly defined boundaries and captured baseline carbon footprint for 2012, as explained above.

Political and charitable donations

No political donations were made in 2012.

The Group's Corporate Social Investment (CSI) expenditure supports initiatives that benefit the Project Affected Communities

Directors' report continued

in the areas of health, education, infrastructure development, development of small to medium enterprises (SME's), regional environmental initiatives and general donations to relevant causes in project affected communities. In 2012, the Company contributed US$2.5 million to these social initiatives.

Employee policies and involvement

This report is to be read with the information on employment matters contained in the Sustainable Development overview (SD overview) on pages 40 and 47 together with the full Sustainable Development Report which can be found on our website www.gemdiamonds.com. The Group's employment practices have been developed to ensure that the Group attracts and retains the required calibre of management and staff by creating an environment that incentivises enhanced performance. The health, safety and effective performance of employees, together with the maintenance of positive employee relations is of key importance across the Group's operations.

More generally employees are kept informed of the performance and objectives of the Group through direct involvement and access to the Group's website, published information, the circulation of 'press cuttings' and Group announcements.

It is the Group's policy to communicate openly with employees and encourage dialogue between employees and management.

The Company always seeks to have a direct relationship between its employees and business function management, founded on quality, leadership, effective communication and trust.

The Group is committed to the principle and achievement of equal opportunities in employment irrespective of gender, religion, race or marital status. Full consideration is given to applications from disabled persons who apply for employment where the requirements of the position can be adequately filled by a disabled person, having regard to their particular abilities and aptitude.

The Group sets guidelines and frameworks in respect of Company policy on remuneration benefits, performance management, career development and succession planning, recruitment and expatriate employment and for the alignment of human resources management and policy with international best practice. Each operating unit manages its human resources requirements locally, within the Group's guidelines and framework.

Corporate governance

A report on Corporate Governance and compliance with the provisions of the UK Corporate Governance Code (the Code) is set out on pages 52 to 59.

Going concern

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business review on pages 16 to 47. The financial position of the Company, its cashflows and liquidity position are described in the Business review on pages 32 to 35. In addition, Note 28 and 29 to the financial statements includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments; and its exposures to credit and liquidity risk.

After making enquiries which include reviews of forecasts and budgets, timing of cashflows, borrowing facilities and sensitivity analyses and considering the uncertainties described in this report either directly or by cross reference, the Directors have a reasonable expectation that the Group and the Company have adequate financial resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Annual Report and Accounts of the Company.

Directors

The Directors, as at the date of this report, are listed on pages 50 and 51, together with their biographical details. Details of Directors' interests in shares and share options of the Company can be found in the Director's remuneration report on pages 68 to 79.

Directors who held office during the year

	Date of appointment
Executive Directors	
CT Elphick	20 January 2006
AR Ashworth	22 April 2008
KM Burford	20 January 2006
GE Turner	22 April 2008

	Date of appointment
Non-Executive Directors	
RW Davis	1 February 2007
GA Beevers	1 February 2007
DJ Elzas	18 October 2005
M Salamon	3 February 2008
RJ Williams	3 February 2008

There has been no change in the above appointments since 1 January 2012 to the date of this report.

Re-election of Directors

The Articles of Association (81) provides that a third of Directors retire by rotation and being eligible, offer themselves for re-election. However in accordance with the Code at each year's AGM, all the Directors will retire and, subject to them being eligible, will offer themselves for re-election. Each has been the subject of a Board evaluation.

Annual General Meeting (AGM)

Details of the resolutions which will be put to the AGM are given in the notice of the AGM, which is contained in a separate document from the Annual Report.

Share capital

Details of the authorised and issued share capital of the Company, including the rights pertaining to each share class, are set out in Note 20 to the Financial Statements.

Major interests in shares

Details of the major interests (at or above 3%) in the issued ordinary shares of the Company are set out in the Corporate Governance Report on Page 59.

Directors' interests

No Director had, at any time during the year, a material interest in any contract of significance in relation to the Company's business. The interest of Directors in the shares of the Company is included in the Directors' Remuneration Report on Page 79.

Directors' report continued

Creditors' payment practice

In view of the international nature of the Group's operations there is no specific Group-wide policy in respect of payments to suppliers. Individual operating companies are responsible for agreeing terms and conditions for their business transactions and ensuring that suppliers are aware of the terms of payment. It is Group practice that payments are made in accordance with those terms, provided that all trading terms and conditions have been met by the supplier. Trade creditors at 31 December 2012 represented 72 days of the Gem Diamonds Limited's annual purchases.

Electronic copies of documents

Copies of the 2012 Annual Report, HSSE policies and other corporate publications, reports, press releases and announcements are available on the Company's website at www.gemdiamonds.com

Disclosure of information and auditor re-election

The lead audit partner is based in London, UK.

As required under section 418 of the Companies Act 2006, to which the Directors have voluntarily elected to conform, each Director confirms that to the best of his knowledge and belief, there is no information relevant to the preparation of the auditor's report of which the Company's auditors are unaware and that each Director has taken all reasonable steps as a Director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

A resolution to re-appoint Ernst & Young LLP as the Company's auditors and to authorise the Board to determine the auditor's remuneration will be proposed at the 2013 Annual General Meeting.

By order of the Board

André Confavreux
Company Secretary
11 March 2013

Responsibility statement of the Directors in respect of the Annual Report and financial statements

The Directors are responsible for preparing the Annual Report and the Group financial statements in accordance with International Financial Reporting Standards (IFRS).

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors confirm that the financial statements, prepared in accordance with IFRS, give a true and fair view of the assets, liabilities, financial position and profit of the Company and the undertakings included in the consolidation taken as a whole.

The Business review includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Information, including accounting policies, has been presented in a manner that provides relevant, reliable, comparable and understandable information and additional disclosures have been provided when compliance with the specific requirements in IFRS have been insufficient to enable users to understand the financial impact of particular transactions, other events and conditions on the Group's financial position and financial performance. Where necessary, the Directors have made judgements and estimates that are reasonable and prudent.

The Directors of the Company have elected to comply with certain Companies Act and Listing Rules (LR) which would otherwise only apply to companies incorporated in the UK – namely:

(a) the Directors' statement under LR 9.8.6R (3) (statement by the Directors that the business is a going concern);

(b) the Directors' remuneration disclosures made under LR 9.8.8R (2) – (5) and (11) – (12); and

(c) the requirements of Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 of the United Kingdom pertaining to Directors' remuneration that UK quoted companies are required to comply with.

Kevin Burford
Chief Financial Officer

11 March 2013

Independent auditor's report to the members of Gem Diamonds Limited

We have audited the Group financial statements of Gem Diamonds Limited (the Company) and its subsidiaries (together 'the Group') for the year ended 31 December 2012 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Financial Position, the Consolidated Statement of Changes in Equity, the Consolidated Statement of Cash Flows and the related notes 1 to 30. The financial reporting framework that has been applied in their preparation is International Financial Reporting Standards (IFRSs).

This report is made solely to the Company's members in accordance with the terms of our letter of engagement dated August 2011 (Addendum to the engagement 2 March 2012). Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

As explained more fully in the Directors' Responsibility Statement set out on page 85, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the Group financial statements in accordance with International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

In addition the company has also instructed us to:

- report as to whether the Directors' report for the financial year for which the Group financial statements are prepared is consistent with the financial statements.
- report as to whether the information given in the Corporate governance statement with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.
- report as to whether the section of the Directors' remuneration report that is described as audited has been properly prepared in accordance with the basis of preparation described therein.
- report if we are not satisfied that:
    1. adequate accounting records have been kept (including returns from those branches which have not been visited); or
    2. the accounts are in agreement with the records and returns; or
    3. we have obtained all the information and explanations which we consider necessary for the purpose of the audit.
- review certain elements of the report to shareholders by the board on Directors' remuneration, which for a premium listed UK incorporated company is specified for review by the Listing Rules of the Financial Services Authority.
- review the Directors' statement in relation to going concern as set out on page 82, which for a premium listed UK incorporated company is specified for review by the Listing Rules of the Financial Services Authority.

Scope of the audit and the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances, and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2012 and of its loss for the year then ended; and
- have been properly prepared in accordance with IFRSs.

Opinion on other matters as per our terms of engagement with the company

In our opinion:

- the information given in the Directors' report for the financial year for which the Group financial statements are prepared is consistent with the financial statements;
- the information given in the Corporate governance statement set out on pages 52 to 59 with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements; and
- the part of the Remuneration report of the Company that has been described as audited has been properly prepared in accordance with the basis of preparation as described therein.

Matters on which we report by exception

We have nothing to report in respect of the following:

Under the Listing Rules we are required to review the part of the Corporate governance statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code, specified in for our review.

Under the terms of our engagement we agreed to report to you if, in our opinion:

- adequate accounting records have not been kept, (including returns from those branches which have not been visited); or
- the accounts are not in agreement with the records and returns; or
- we have not obtained all the information and explanations which we consider necessary for the purpose of the audit.

Where the company has also instructed us to review:

- certain elements of the report to shareholders by the board on Director's remuneration.
- the Directors' statement, set out on page 82, in relation to going concern.

Ernst & Young LLP
1 More London Place
London

11 March 2013

Consolidated Income Statement

For the year ended 31 December 2012

	Notes	2012 US$'000 Before exceptional items	2012 US$'000 Exceptional items	2012 US$'000 Total	2011* US$'000 Before exceptional items	2011* US$'000 Exceptional items	2011* US$'000 Total
Revenue	2	**202 118**	**–**	**202 118**	306 142	–	306 142
Cost of sales		**(120 478)**	**–**	**(120 478)**	(117 410)	–	(116 550)
Gross profit		**81 640**	**–**	**81 640**	188 432	–	189 592
Other operating income	3	**1 271**	**–**	**1 271**	40	–	40
Royalties and selling costs		**(19 142)**	**–**	**(19 142)**	(26 527)	–	(26 527)
Corporate expenses		**(15 629)**	**–**	**(15 629)**	(17 291)	–	(17 291)
Share-based payments	31	**(2 281)**	**–**	**(2 281)**	(1 310)	–	(1 310)
Foreign exchange gain	3	**3 815**	**–**	**3 815**	6 882	–	6 882
Impairment of assets	4	**–**	**(16 241)**	**(16 241)**	–	–	–
Operating profit	3	**49 674**	**(16 241)**	**33 433**	150 526	–	150 526
Net finance income	5	**1 312**	**–**	**1 312**	2 108	–	2 108
Finance income		**2 564**	**–**	**2 564**	3 157	–	3 157
Finance costs		**(1 252)**	**–**	**(1 252)**	(1 049)	–	(1 049)
Profit before tax		**50 986**	**(16 241)**	**34 745**	152 634	–	152 634
Income tax expense	6	**(18 407)**	**–**	**(18 407)**	(52 946)	–	(52 946)
Profit for the year		**32 579**	**(16 241)**	**16 338**	99 688	–	99 688
(Loss)/profit after tax for the year from discontinued operations	8	**–**	**(118 686)**	**(118 686)**	–	6 228	6 228
(Loss)/profit after tax		**–**	**(70 297)**	**(70 297)**	–	6 228	6 228
Recycling of foreign currency translation reserve on discontinued operation	8	**–**	**(48 389)**	**(48 389)**	–	–	–
(Loss)/profit for the year		**32 579**	**(134 927)**	**(102 348)**	99 688	6 228	105 916
Attributable to:							
Non-controlling interests		**15 507**	**–**	**15 507**	38 247	–	38 247
Equity holders of parent		**17 072**	**(134 927)**	**(117 855)**	61 441	6 228	67 669
– Profit for the year		**17 072**	**(16 241)**	**831**	61 441	–	61 441
– Profit for the year from discontinued operations		**–**	**(118 686)**	**(118 686)**	–	6 228	6 228
Earnings per share (cents)	10						
– Basic earnings per share		**12**	**(86)**	**(74)**	44	5	49
– Diluted earnings per share **		**12**	**(85)**	**(73)**	44	4	48

* The prior year figures have been restated for the reclassification impact of accounting for discontinued operations (Refer Note 8, discontinued operations).

** Options are dilutive at the profit from continuing operations level and thus in accordance with IAS33 have been treated as dilutive for the purpose of dilutive earnings per share. The diluted loss per share is lower than basic loss per share because of the losses on discontinued operations.

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2012

	Notes	2012 US$'000	2011 US$'000
(Loss)/profit for the year		**(102 348)**	105 916
Loss on valuation of available-for-sale financial assets		**(204)**	(702)
Exchange differences on translation of foreign operations		**(23 237)**	(70 430)
Recycling of exchange differences on discontinued operation	8	**48 389**	–
Impairment of available-for-sale financial assets		**906**	–
Other comprehensive profit/(loss) for the year		**25 854**	(71 132)
Total comprehensive (loss)/income for the year		**(76 494)**	34 784
Attributable to:			
Equity holders of the parent		**(89 378)**	16 042
Non-controlling interests		**12 884**	18 742
Total comprehensive (loss)/income for the year		**(76 494)**	34 784

Consolidated Statement of Financial Position

As at 31 December 2012

	Notes	2012 US$'000	2011 US$'000
Assets			
Non-current assets			
Property, plant and equipment	11	**408 605**	424 937
Investment property	12	**616**	617
Intangible assets	13	**24 973**	25 529
Other financial assets	15	**14**	14 587
		434 208	465 670
Current assets			
Inventories	17	**22 652**	39 222
Receivables	18	**7 273**	10 145
Other financial assets	15	**16 444**	9
Cash and short-term deposits	19	**70 842**	158 750
		117 211	208 126
Total assets		**551 419**	673 796
Equity and liabilities			
Equity attributable to equity holders of the parent			
Issued capital	20	**1 383**	1 383
Share premium		**885 648**	885 648
Own shares[1]		**(1)**	(1)
Other reserves	20	**(17 130)**	(48 720)
Accumulated losses		**(539 261)**	(421 406)
		330 639	416 904
Non-controlling interests		**70 993**	66 879
Total equity		**401 632**	483 783
Non-current liabilities			
Trade and other payables	21	**1 007**	667
Provisions	22	**29 496**	43 201
Deferred tax liabilities	16	**71 277**	68 061
		101 780	111 929
Current liabilities			
Interest-bearing loans and borrowings	24	**2 947**	–
Trade and other payables	21	**43 775**	57 098
Income tax payable		**1 285**	20 986
		48 007	78 084
Total liabilities		**149 787**	190 013
Total equity and liabilities		**551 419**	673 796

[1] Shares held by Gem Diamonds Limited Employee Share Trust.

Approved by the Board of Directors on 11 March 2013 and signed on their behalf by:

C T Elphick
Director

K M Burford
Director

Consolidated Statement of Changes in Equity

For the year ended 31 December 2012

	Issued capital[2]	Share premium[2]	Own shares[1]	Other reserves[2]	Accumulated losses)/ retained earnings	Total	Non-controlling interests	Total equity
				Attributable to the equity holders of the parent				
Balance at 1 January 2012	**1 383**	**885 648**	**(1)**	**(48 720)**	**(421 406)**	**416 904**	**66 879**	**483 783**
Loss for the year	**–**	**–**	**–**	**–**	**(117 855)**	**(117 855)**	**15 507**	**(102 348)**
Other comprehensive income	**–**	**–**	**–**	**28 477**	**–**	**28 477**	**(2 623)**	**25 854**
Total comprehensive income	**–**	**–**	**–**	**28 477**	**(117 855)**	**(89 378)**	**12 884**	**(76 494)**
Share-based payments (Note 30)	**–**	**–**	**–**	**3 113**	**–**	**3 113**	**–**	**3 113**
Dividends paid	**–**	**–**	**–**	**–**	**–**	**–**	**(8 770)**	**(8 770)**
Balance at 31 December 2012	**1 383**	**885 648**	**(1)**	**(17 130)**	**(539 261)**	**330 639**	**70 993**	**401 632**
Balance at 1 January 2011	1 383	885 648	(1)	1 325	(489 075)	399 280	84 791	484 071
Profit for the year	–	–	–	–	67 669	67 669	38 247	105 916
Other comprehensive income	–	–	–	(51 627)	–	(51 627)	(19 505)	(71 132)
Total comprehensive income	**–**	**–**	**–**	(51 627)	67 669	16 042	18 742	34 784
Share-based payments (Note 30)	–	–	–	1 582	–	1 582	–	1 582
Dividends paid	–	–	–	–	–	–	(36 654)	(36 654)
Balance at 31 December 2011	1 383	885 648	(1)	(48 720)	(421 406)	416 904	66 879	483 783

1 Being shares held by Gem Diamonds Limited Employee Share Trust.

2 Refer Note 20, Issued Capital and Reserves for further detail.

Consolidated Statement of Cash flows

As at 31 December 2012

	Notes	2012 US$'000	2011 US$'000
Cash flows from operating activities		**90 199**	203 288
Cash generated by operations	23.1	**143 699**	216 680
Working capital adjustments	23.2	**(25 084)**	3 994
		118 615	220 674
Finance income	23.1	**3 109**	3 766
Finance cost		**(213)**	(36)
Income tax paid		**(31 312)**	(21 116)
Cash flows used in investing activities		**(170 883)**	(125 030)
Purchase of property, plant and equipment		**(69 000)**	(44 913)
Waste cost capitalised		**(96 617)**	(87 314)
Proceeds from sale of property, plant and equipment		**1 144**	2 637
Acquisition of business combination	9	**(786)**	–
Purchase of other financial assets		**(5 015)**	(340)
Cash (disposed of)/received from disposal of subsidiary	23.3	**(609)**	4 900
Cash flows used in financing activities		**(5 728)**	(36 654)
Financial liabilities raised		**3 042**	–
Dividends paid to non-controlling interests	26	**(8 770)**	(36 654)
Net (decrease)/increase in cash and cash equivalents		**(86 412)**	41 604
Cash and cash equivalents at the beginning of the year – continuing operations		**158 750**	129 849
Cash and cash equivalents at the beginning of the year – discontinued operations		**–**	78
Foreign exchange differences		**(1 496)**	(12 781)
Cash and cash equivalents at end of the year held with banks		**70 681**	157 165
Restricted cash at end of the year	19	**161**	1 585
Cash and cash equivalents at end of the year	19	**70 842**	158 750

Notes to the Annual Financial Statements

For the year ended 31 December 2012

1. Notes to the financial statements

1.1 Corporate information

1.1.1 Incorporation

The holding company, Gem Diamonds Limited (the 'Company'), was incorporated on 29 July 2005 in the British Virgin Islands. The Company's registration number is 669758.

These financial statements were authorised for issue by the Board on 11 March 2013.

1.1.2 Operational information

The Company has the following investments directly in subsidiaries at 31 December 2012:

Name of company	Share-holding	Cost of investment[1]	Country of incorporation	Nature of business
Subsidiaries				
Gem Diamond Technical Services (Proprietary) Limited[2]	100%	US$17	RSA	Technical, financial and management consulting services.
Gem Equity Group Limited[2]**	100%	US$52 277	BVI	Dormant investment company holding 1% in Gem Diamonds Botswana (Proprietary) Limited, 2% in Gem Diamonds Marketing Services BVBA, 1% in Baobab Technologies BVBA and 0.1% in Calibrated Gem Botswana (Proprietary) Limited.
Letšeng Diamonds (Proprietary) Limited[2]	70%	US$126 000 303	Lesotho	Diamond mining and holder of mining rights.
Gem Diamonds Botswana (Proprietary) Limited[2]	100%	US$27 752 144	Botswana	Diamond mining; evaluation and development; and holder of mining licences and concessions.
BDI Mining Corp[2]	100%	US$82 064 783	BVI	Dormant investment company.
Gem Diamonds Australia Holdings[21]*	100%	US$293 960 521	Australia	Investment company holding 100% in Kimberley Diamonds Company NL.
Gem Diamonds Investments Limited[2]**	100%	US$17 531 316	UK	Investment holding company holding 100% in each of Gem Diamonds Technology (Mauritius) Limited, Gem Diamonds Technology DMCC and Calibrated Diamonds Investment Holdings (Proprietary) Limited; 99.9% in Calibrated Gem Botswana (Proprietary) Limited; 99% in Baobab Technologies BVBA and 98% in Gem Diamonds Marketing Services BVBA.

1 The cost of investment represents original cost of investments at acquisition dates.

2 No change in the shareholding since the prior year.

* The Group entered into a sale agreement on 30 November 2012 for the sale of its Australian mining activities, the Ellendale mine (Kimberley Diamonds Company NL), with an effective date of 31 December 2012. As a result of the terms of the agreement entered into, the Group lost control of Kimberley Diamonds Company NL. As a result, the trading results of the operation have been classified as part of discontinued operations and the net assets have been derecognised and an investment was recorded as an available for sale investment at fair value.

**On May 2012 Baobab Technologies BVBA was formed, a 100% held company within Gem Diamonds Investment Limited.

1.1.3 Segment information

For management purposes, the Group is organised into geographical units as the Group's risks and required rates of return are affected predominantly by differences in the geographical regions of the mines and areas in which the Group operates. Other regions where no direct mining activities take place (includes the remaining dormant operations of the Australian region post the sale of the Australian mining operations) are organised into geographical regions in the areas where the operations are managed. The main geographical regions are:

- Lesotho (Mining activities)
- Australia (Mining activities)
- Botswana (Mining activities)
- Belgium (Sales, marketing and manufacturing for the sale of diamonds in Antwerp)
- BVI, RSA and UK (Technical and administrative services)

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

1. Notes to the financial statements continued

1.1.3 Segment information continued

Management monitors the operating results of the geographical units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss. However, Group financing (including finance costs and finance income) and income taxes are managed on a group basis and are not allocated to operating segments.

Inter-segment transactions are entered into under normal arm's length terms in a manner similar to transactions with third parties. Segment revenue, segment expenses and segment results include transactions between segments. Those transactions are eliminated on consolidation.

Segment revenue is derived from mining activities and group services.

The following table presents revenue and profit, asset and liability information from operations regarding the Group's geographical segments:

Year ended 31 December 2012	Lesotho (US$'000)	Botswana (US$'000)	Belgium (US$'000)	BVI, RSA and UK (US$'000)	Total Continuing operations (US$'000)	Discontinued operations (US$'000)	Total (US$'000)
Sales							
Total sales	**207 744**	**–**	**201 433**	**10 198**	**419 375**	**113 704**	**533 079**
Inter-segment sales	**(205 492)**	**–**	**(1 729)**	**(10 036)**	**(217 257)**	**–**	**(217 257)**
Sales to external customers	**2 252**	**–**	**199 704**	**162**	**202 118**	**113 704**	**315 822**
Results							
Depreciation and amortisation	**44 618**		**350**	**1 035**	**46 003**	**49 530**	**95 533**
Depreciation and mining asset amortisation	**17 651**	**–**	**350**	**1 035**	**19 036**	**18 278**	**37 314**
Waste amortisation	**26 967**	**–**	**–**	**–**	**26 967**	**31 252**	**58 219**
Share-based equity transactions	**305**	**–**	**–**	**1 976**	**2 281**	**650**	**2 931**
Impairment	**1 428**	**–**	**–**	**14 813**	**16 241**	**4 121**	**20 362**
Segment operating profit/(loss)	**67 683**	**(246)**	**13**	**(34 017)**	**33 433**	**(6 107)**	**27 326**
Net finance income/(cost)					**1 312**	**(493)**	**819**
Profit/(loss) before tax from operations					**34 745**	**(6 600)**	**28 145**
Income tax expense					**(18 407)**	**–**	**(18 407)**
Re-measurement to fair value					**–**	**(63 697)**	**(63 697)**
Recycling of foreign currency translation reserve on disposal of subsidiary					**–**	**(48 389)**	**(48 389)**
Profit/(loss) for the year					**16 338**	**(118 686)**	**(102 348)**
Segment assets	**372 778**	**100 490**	**15 379**	**62 772**	**551 419**	**–**	**551 419**
Segment liabilities	**51 042**	**6 702**	**2 769**	**17 997**	**78 510**	**–**	**78 510**
Other segment information							
Capital expenditure							
– Property, plant and equipment*	**31 677**	**36 731**	**2 124**	**1 687**	**72 219**	**15 457**	**87 676**
– Waste cost capitalised	**60 559**	**–**	**–**	**–**	**60 559**	**36 058**	**96 617**
Total capital expenditure	**92 236**	**36 731**	**2 124**	**1 687**	**132 778**	**51 515**	**184 293**

*Capital expenditure includes movements in rehabilitation assets relating to changes in rehabilitation estimates.

1.1.3 Segment information continued

Included in total annual revenue is revenue from a customer which amounted to US$88.7 million arising from sales reported in the Australian segment.

Segment liabilities do not include deferred tax liabilities of US$71.3 million.

Total sales for the period are lower than that in the prior period as a result of the current market conditions and lower diamonds prices at both the Lesotho and Australian operations.

Year ended 31 December 2011	Lesotho (US$'000)	Botswana (US$'000)	Belgium (US$'000)	BVI, RSA and UK (US$'000)	Total continuing operations (US$'000)	Discontinued operations (US$'000)	Total (US$'000)
Sales							
Total sales	300 587	–	300 244	13 968	614 799	89 432	704 231
Inter-segment sales	(297 027)	–	(58)	(11 572)	(308 657)	–	(308 657)
Sales to external customers	3 560	–	300 186	2 396	306 142	89 432	395 574
Results							
Depreciation and amortisation	40 594	–	279	1 735	42 608	27 382	69 990
– Depreciation and mining asset amortisation	21 970	–	279	1 735	23 984	8 720	32 704
– Waste amortisation	18 624	–	–	–	18 624	18 662	37 286
Share-based equity transactions	129	–	–	1 181	1 310	145	1 455
Resource extension development costs	–	–	–	–	–	1 767	1 767
Segment operating profit/(loss)	167 442	161	1 285	(18 362)	150 526	6 198	156 724
Net finance income/(cost)					2 108	(278)	1 830
Share of profit of associate					–	308	308
Profit before tax from continuing operations					152 634	6 228	158 862
Income tax expense					(52 946)	–	(52 946)
Profit for the period					99 688	6 228	105 916
Segment assets	371 503	66 749	3 966	113 682	555 900	117 896	673 796
Segment liabilities	54 620	2 952	2 324	3 042	62 938	59 014	121 952
Other segment information							
Capital expenditure							
– Property, plant and equipment	18 714	21 791	11	1 091	41 607	19 738	61 345
– Waste cost capitalised	56 486	–	–	–	56 486	30 828	87 314
Total capital expenditure	75 200	21 791	11	1 091	98 093	50 566	148 659

*Capital expenditure includes movements in rehabilitation assets relating to changes in rehabilitation estimates.

Included in the prior year annual revenue, is revenue from two customers which amount to US$134.4 million arising from sales reported in the Lesotho, Belgium and Australian segments.

Segment liabilities do not include deferred tax liabilities of US$68.1 million.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

1. Notes to the financial statements continued

1.2 Summary of significant accounting policies

1.2.1 Basis of presentation

The financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS). These financial statements have been prepared under the historical cost basis, except as modified by the revaluation for available-for-sale financial assets through other comprehensive income and derivative financial instruments at fair value through profit or loss. The accounting policies have been consistently applied except for the adoption of the new standards and interpretations detailed below.

The functional currency of the Company and certain of its subsidiaries is the US dollar, which is the currency of the primary economic environment in which the entities operate. All amounts are expressed in US dollars. The financial statements of subsidiaries whose functional and reporting currency is in currencies other than the US dollar have been converted into US dollars on the basis as set out in Note 1.2.14. Foreign currency translations.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 1.2.25. Critical accounting estimates and judgements.

The Group has also adopted the following standards and interpretations from 1 January 2012:

IFRS 7 Financial Instruments: Disclosures – Enhanced Derecognition Disclosure Requirements (Amendment)

The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the Group's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about the entity's continuing involvement in derecognised assets to enable the users to evaluate the nature of, and risks associated with, such involvement. The amendment is effective for annual periods beginning on or after 1 July 2011. The Group does not have any assets with these characteristics so there has been no effect on the presentation of its financial statements.

IAS 12 Income Taxes – Deferred Taxes: Recovery of Underlying Assets (Amendment)

The IASB has issued an amendment to IAS 12 that introduces a rebuttable presumption that deferred tax on investment properties measured at fair value be recognised on a sale basis. The presumption can be rebutted if the entity applies a business model that would indicate that substantially all of the investment property will be consumed in the business, in which case an own-use basis must be adopted. The Group measures its investment property at cost and therefore this amendment had no effect on the financial position or performance of the Group.

1.2.1 Basis of presentation continued

Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Groups financial statements are disclosed below. The Group intends to adopt these standards if applicable when they become effective.

Standard or Interpretation			Effective Date*
IAS 28	Investments in Associates and Joint Ventures	The revised standard caters for joint ventures in addition to prescribing the accounting for investments in associates. The amendment has no impact on the Group.	1 January 2013
IAS 32	Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32	Clarification of the meaning of "currently has a legally enforceable right to set-off" and clarification of offsetting criteria to settlement systems. Based on the preliminary analyses performed it is not expected to have any impact on the currently held investments of the Group.	1 January 2014
IFRS 7	Disclosures – Offsetting Financial Assets and Financial Liabilities – Amendments to IFRS 7	Disclosure of information about rights to set-off and related arrangements to provide information that is useful to users in evaluating the effect of netting arrangements. Based on the preliminary analyses performed this is not expected to have any impact on the currently held investments of the Group.	1 January 2013
IFRS 9	Financial Instruments: Classification and Measurement	Classification and measurement of financial assets and financial liabilities as defined in IAS 39. Measurement of fair value. Based on preliminary analyses no material impact is expected.	1 January 2015
IFRS 10, IAS 27	Consolidated Financial Statements, Separate Financial Statements	Guidance on accounting for consolidated financial statements and includes a revised definition of control. Based on the preliminary analyses performed this amendment is not expected to have any impact on the currently held investments of the Group.	1 January 2013
IFRS 11	Joint Arrangements	Joint ventures to be accounted for using the equity method therefore eliminating the proportionate consolidation of the joint venture and includes a revised definition of joint control. The application of this new standard will not impact the financial position of the Group.	1 January 2013
IFRS 12	Disclosure of Interests in Other Entities	Includes additional disclosures as well as those disclosures previously in IAS 27, IAS 28 and IAS 31. New disclosures are required but this is not expected to impact on the Group's financial position or performance.	1 January 2013
IFRS 13	Fair Value Measurement	Measurement of fair value. Based on preliminary analyses no material impact is expected.	1 January 2013
IFRIC 20	Stripping Costs in the Production Phase of a Surface Mine	Accounting for the benefit from stripping in surface mining activity. As the Group's application is in line with IFRIC 20 the application of this new standard will not impact the financial position of the Group.	1 January 2013

* Annual periods beginning on or after.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

1. Notes to the financial statements continued

1.2.1 Basis of presentation continued

Business environment and country risk

The Group's operations are subject to country risk being the economic, political and social risks inherent in doing business in certain areas of Africa, Europe and Australia. These risks include matters arising out of the policies of the government, economic conditions, imposition of or changes to taxes and regulations, foreign exchange rate fluctuations and the enforceability of contract rights.

The consolidated financial information reflects management's assessment of the impact of these business environments on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

1.2.2 Going concern

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business review. The financial position of the Company, its cash flows and liquidity position are described in the Business review. In addition, Note 29, Financial risk management, includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and its exposures to credit risk and liquidity risk.

After making enquiries which include reviews of forecasts and budgets, timing of cash flows, borrowing facilities and sensitivity analyses and considering the uncertainties described in this report either directly or by cross reference, the Directors have a reasonable expectation that the Group and the Company have adequate financial resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the annual report and accounts of the Company.

These financial statements have been prepared on a going concern basis which assumes that the Group will be able to meet its liabilities as they fall due for the foreseeable future.

Refer to Note 29, Financial Risk Management for statements on the Company's objectives, policies and processes for managing its capital; details of its financial instruments and hedging activities; its exposures to market risk in relation to commodity price and foreign exchange risks; cash flow interest rate risk; credit risk and liquidity risk.

1.2.3 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

Basis of consolidation

Subsidiaries

Subsidiaries are consolidated from the date of their acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. Control comprises the power to govern the financial and operating policies of the investee so as to obtain benefit from its activities and is achieved through direct or indirect ownership of voting rights; currently exercisable or convertible potential voting rights; or by way of contractual agreement. The financial statements of subsidiaries used in the preparation of the consolidated financial statements are prepared for the same reporting year as the parent company and are based on consistent accounting policies. All intragroup balances and transactions, including unrealised profits arising from them, are eliminated in full.

A change in the ownership interest of a subsidiary, without loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it (i) derecognises the assets (including goodwill) and liabilities of the subsidiary; (ii) derecognises the carrying amount of any non-controlling interest; (iii) derecognises the cumulative translation differences, recorded in equity; (iv) recognises the fair value of the consideration received; (v) recognises the fair value of any investment retained; (vi) recognises any surplus or deficit in profit or loss; (vii) reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss or retained earnings, as appropriate.

1.2.3 Basis of consolidation continued

Non-controlling interests

Non-controlling interests represent the equity in a subsidiary not attributable, directly and indirectly, to the parent company and is presented separately within equity in the consolidated statement of financial position, separately from equity attributable to owners of the parent. Losses within a subsidiary are attributed to the non-controlling interest even if that results in a deficit balance.

1.2.4 Exploration and evaluation expenditure

Exploration and evaluation activity involves the search for mineral resources, the determination of technical feasibility and the assessment of commercial viability of an identified resource. Exploration and evaluation activity includes:

- acquisition of rights to explore;
- researching and analysing historical exploration data;
- gathering exploration data through topographical, geochemical and geophysical studies;
- exploratory drilling, trenching and sampling;
- determining and examining the volume and grade of the resource;
- surveying transportation and infrastructure requirements; and
- conducting market and finance studies.

Administration costs that are not directly attributable to a specific exploration area are charged to the income statement. Licence costs paid in connection with a right to explore in an existing exploration area are capitalised and amortised over the term of the permit.

Exploration and evaluation expenditure is capitalised as incurred. Capitalised exploration expenditure is recorded as a component of property, plant and equipment at cost less accumulated impairment charges. As the asset is not available for use, it is not depreciated.

All capitalised exploration and evaluation expenditure is monitored for indications of impairment. Where a potential impairment is indicated, assessments are performed for each area of interest in conjunction with the group of operating assets (representing a cash-generating unit (CGU)) to which the exploration is attributed. To the extent that exploration expenditure is not expected to be recovered, it is charged to the income statement. Exploration areas where reserves have been discovered, but require major capital expenditure before production can begin, are continually evaluated to ensure that commercial quantities of reserves exist or to ensure that additional exploration work is underway as planned.

1.2.5 Development expenditure

When proved reserves are determined and development is sanctioned, capitalised exploration and evaluation expenditure is reclassified within property, plant and equipment to development expenditure. As the asset is not available for use, during the development phase, it is not depreciated. On completion of the development, any capitalised exploration and evaluation expenditure already capitalised to development expenditure, together with the subsequent development expenditure, is reclassified within property, plant and equipment to mining assets and depreciated on the basis as laid out in Note 1.2.6. Property, plant and equipment.

All development expenditure is monitored for indications of impairment annually.

1.2.6 Property, plant and equipment

Property, plant and equipment is recorded at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditure that is directly attributable to the acquisition and construction of the items, amongst others, professional fees, and for qualifying assets, borrowing costs capitalised in accordance with the Group's accounting policy.

Subsequent costs to replace a component of an item of property, plant and equipment that is accounted for separately, is capitalised when the cost of the item can be measured reliably, with the carrying amount of the original component being written off. All repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

1. Notes to the financial statements continued

Depreciation commences when an asset is available for use. Depreciation is charged so as to write off the depreciable amount of the asset to its residual value over its estimated useful life, using a method that reflects the pattern in which the asset's future economic benefits are expected to be consumed by the Group.

Depreciation methods, useful lives and residual values are reviewed, and adjusted if appropriate, at each balance sheet date. The following methods and useful lives were applied during the period:

Item	Method	Useful life
Mining assets	Straight line	Lesser of life of mine and period of lease
Decommissioning assets	Straight line	Lesser of life of mine and period of lease
Leasehold improvements	Straight line	Lesser of 3 years and period of lease
Plant and equipment	Straight line	3 – 10 years
Finance lease assets	Straight line	Lesser of period of lease or 5 years
Other assets	Straight line	2 – 5 years

Pre-production mine stripping costs are capitalised to development costs. Stripping costs incurred during the production phase to remove additional overburden or waste ore are deferred when they give access to future economic benefits and charged to operating costs using the expected average stripping ratio over the average life of the area being mined. The average stripping ratio is calculated as the number of tonnes of waste material expected to be removed during the life of area, per tonne of ore mined.

The average life of area cost per tonne is calculated as the total expected costs to be incurred to mine the ore body divided by the number of tonnes expected to be mined. The average life of area stripping ratio and the average life of area cost per tonne are recalculated annually in light of additional knowledge and changes in estimates. Changes in the stripping ratio are accounted for prospectively as a change in estimate.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount of the asset. These are included in the income statement.

1.2.7 Investment property

Investment property is initially recognised using the cost model. Subsequent recognition is at cost less accumulated depreciation and less any accumulated impairment losses. Rental income from investment property is recognised on a straight line basis over the term of the lease. Initial direct costs incurred in negotiating and arranging the lease are capitalised to investment property and depreciated over the lease term. Depreciation is calculated on a straight line basis as follows:

Investment property	No depreciation is provided for due to depreciable amount being zero
Initial direct costs capitalised to investment property	5 years

1.2.8 Business combinations, goodwill and other intangible assets

Business combinations and goodwill

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. The choice of measurement of non-controlling interest, either at fair value or at the proportionate share of the acquiree's identifiable net assets is determined on a transaction by transaction basis. Acquisition costs incurred are expensed and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability will be recognised in accordance with IAS 39 either in profit or loss or in other comprehensive income. If the contingent consideration is classified as equity, it should not be re measured until it is finally settled within equity.

Goodwill is initially measured at cost being the excess of the aggregate of the acquisition-date fair value of the consideration transferred and the amount recognised for the non-controlling interest (and where the business combination is achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree) over the net identifiable amounts of the assets acquired and the liabilities assumed in exchange for the business combination. Assets acquired and liabilities assumed in transactions separate to the business combinations, such as the settlement of pre-existing relationships or post-acquisition remuneration arrangements are accounted for separately from the business combination in accordance with their nature and applicable IFRSs. Identifiable intangible assets, meeting either the contractual-legal or separability criterion are recognised separately from goodwill. Contingent liabilities representing a present obligation are recognised if the acquisition-date fair value can be measured reliably.

If the aggregate of the acquisition-date fair value of the consideration transferred and the amount recognised for the non-controlling interest (and where the business combination is achieved in stages, the acquisition-date fair value of the 'acquirer's previously held equity interest in the acquiree) is lower than the fair value of the assets, liabilities and contingent liabilities and the fair value of any pre-existing interest held in the business acquired, the difference is recognised in profit and loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units (or groups of cash-generating units) that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. Each unit or group of units to which goodwill is allocated shall represent the lowest level within the entity at which the goodwill is monitored for internal management purposes and not be larger than an operating segment before aggregation.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

1. Notes to the financial statements continued

1.2.8 Business combinations, goodwill and other intangible assets continued

Concessions and licences

Concessions and licences are shown at cost. Concessions and licences have a finite useful life and are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is calculated using the straight line method to allocate the cost of concessions and licences over the shorter of the life of mine or term of the licence once production commences.

1.2.9 Other financial assets

- financial assets at fair value through profit or loss;
- loans and receivables;
- held-to-maturity investments; and
- available-for-sale financial assets.

Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

When financial assets are recognised initially, they are measured at fair value plus (in the case of investments, not at fair value though profit or loss) directly attributable costs.

Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held-for-trading, and those designated at fair value through profit or loss. Upon initial recognition, a financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held-for-trading unless they are designated as hedges. Gains and losses on investments held-for-trading are recognised in profit or loss. Assets in this category are classified as current assets if they are either held-for-trading or are expected to be realised within 12 months of the balance sheet date.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except those with maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Such assets are carried at amortised cost using the effective interest rate method, less any allowance for impairment, if the time value of money is significant. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at an appropriate interest rate. The amount of the provision is recognised in the income statement.

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. If the time value of money is significant, held-to-maturity investments are carried at amortised cost using the effective interest rate method. Gains and losses are recognised in profit or loss when the investments are derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. After initial recognition, available-for-sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in profit or loss.

1.2.9 Other financial assets continued

Fair value

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; discounted cash flow analysis or other valuation models.

Amortised cost

Held-to-maturity investments and loans and receivables are measured at amortised cost. This is computed using the effective interest rate method less any allowance for impairment. The calculation takes into account any premium or discount on acquisition and includes transaction costs and fees that are an integral part of the effective interest rate.

1.2.10 Impairments

Non-financial assets

Assets that are subject to amortisation or depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units). Non-financial assets that were previously impaired are reviewed for possible reversal of the impairment at each reporting date.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such a reversal is recognised in the income statement. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Financial assets

The Group assesses at each balance sheet date whether a financial asset or group of financial assets are impaired.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

1. Notes to the financial statements continued

1.2.10 Impairments continued

Assets carried at amortised cost

If there is objective evidence that an impairment loss on assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the assets carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account. The amount of the loss shall be recognised in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date, any subsequent reversal of an impairment loss is recognised in profit or loss.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Group will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

Available-for-sale financial investments

If an available-for-sale investment is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in profit or loss, is transferred from equity to profit or loss. Reversals in respect of equity instruments classified as available-for-sale are not recognised in profit or loss. Reversals of impairment losses on debt instruments are reversed through profit or loss if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

1.2.11 Inventories

Inventories, which include rough diamonds, ore stock piles and consumables, are measured at the lower of cost and net realisable value. The amount of any write-down of inventories to net realisable value and all losses, are recognised in the period the write-down or loss occurs. Cost is determined as the average cost of production, using the 'first-in-first-out method'. Cost includes directly attributable mining overheads, but excludes borrowing costs.

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs to be incurred in marketing, selling and distribution.

1.2.12 Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at amortised cost. Cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short term, highly liquid investments with original maturities of three months or less.

For the purpose of the cash flow statement, cash and cash equivalents consists of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

1.2.13 Issued share capital

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction from the proceeds.

1.2.14 Foreign currency translations

Presentation currency

The results and financial position of the Group's subsidiaries which have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- balance sheet items are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions);
- all resulting exchange differences are recognised as a separate component of equity.

Details of the rates applied at the respective balance sheet dates and for the income statement transactions are detailed in Note 20, Issued capital and reserves.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at the period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss. Non-monetary items that are measured in terms of cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Monetary items for each balance sheet presented are translated at the closing rate at the date of that balance sheet.

1.2.15 Share-based payments

Employees (including Senior Executives) of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments (equity settled transactions). In situations where some or all of the goods or services received by the entity as consideration for equity instruments cannot be specifically identified, they are measured as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received at the grant date. For cash-settled transactions, the liability is re-measured at each reporting date until settlement, with the changes in fair value recognised in profit or loss.

Equity-settled transactions

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted and is recognised as an expense over the vesting period, which ends on the date on which the relevant employees become fully entitled to the award. Fair value is determined using an appropriate pricing model. In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of the Company (market conditions).

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and management's best estimate of the achievement or otherwise of non-market conditions and of the number of equity instruments that will ultimately vest or, in the case of an instrument subject to a market condition, be treated as vesting as described above. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in equity.

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period. In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification. No reduction is recognised if this difference is negative.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

1. Notes to the financial statements continued

1.2.15 Share-based payments continued

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any cost not yet recognised in the income statement for the award is expensed immediately.

Where an equity-settled award is forfeited, it is treated as if vesting conditions had not been met and all costs previously recognised in the income statement for the award is reversed and recognised in income immediately.

1.2.16 Financial liabilities

Interest-bearing borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement, unless capitalised in accordance with Note 1.2.23. Finance costs, over the period of the borrowings, using the effective interest rate method.

Bank overdrafts are recognised at amortised cost.

Fair value through profit or loss

Financial liabilities at fair value through profit or loss includes financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit and loss.

Financial liabilities are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on liabilities held for trading are recognised in the income statement.

1.2.17 Provisions

Provisions are recognised when:

- the Group has a present legal or constructive obligation as a result of a past event;
- a reliable estimate can be made of the obligation.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation, using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognised as finance costs.

1.2.18 Restoration and rehabilitation

The mining, extraction and processing activities of the Group normally give rise to obligations for site restoration and rehabilitation. Rehabilitation works can include facility decommissioning and dismantling; removal and treatment of waste materials; land rehabilitation; and site restoration. The extent of the work required and the estimated cost of final rehabilitation, comprising liabilities for decommissioning and restoration, are based on current legal requirements, existing technology and the Group's environmental policies and is reassessed annually. Cost estimates are not reduced by the potential proceeds from the sale of property, plant and equipment.

Provisions for the cost of each restoration and rehabilitation programme are recognised at the time the environmental disturbance occurs. When the extent of the disturbance increases over the life of the operation, the provision is increased accordingly. Costs included in the provision encompass all restoration and rehabilitation activity expected to occur. The restoration and rehabilitation provisions are measured at the expected value of future cash flows, discounted to their present value. Discount rates used are specific to the country in which the operation is located. The value of the provision is progressively increased over time as the effect of the discounting unwinds, which is recognised in finance charges. Restoration and rehabilitation provisions are also adjusted for changes in estimates.

When provisions for restoration and rehabilitation are initially recognised, the corresponding cost is capitalised as an asset where it gives rise to a future benefit and depreciated over future production from the operation to which it relates.

1.2.19 Taxation

Income tax for the period comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items charged or credited directly to equity, in which case it is recognised in equity. Current tax expense is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled based on the tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

In respect of taxable temporary differences associated with investments in subsidiaries, associates and jointly controlled entities, deferred tax is provided except where the timing of the reversal of the temporary differences can be controlled by the Group and it is probable that the temporary differences will not reverse in the foreseeable future.

In respect of deductible temporary differences associated with investments in subsidiaries, associates and jointly controlled entities, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

Withholding tax is recognised in the income statement when dividends or other services which give rise to that withholding tax are declared or accrued respectively. Withholding tax is disclosed as part of current tax.

Royalties

Royalties and revenue-based taxes are accounted for under IAS 12 when they have the characteristics of an income tax. This is considered to be the case when they are imposed under Government authority and the amount payable is based on taxable income – rather than based on quantity produced or as a percentage of revenue. For such arrangements, current and deferred tax is provided on the same basis as described above for other forms of taxation. Obligations arising from royalty arrangements that do not satisfy these criteria are recognised as current provisions and disclosed as part of selling and distribution costs. The royalties incurred by the Group are considered not to meet the criteria to be treated as part of income tax.

1.2.20 Employee benefits

Provision is made in the financial statements for all short term employee benefits. Liabilities for wages and salaries, including non monetary benefits, benefits required by legislation, annual leave, retirement benefits and accumulating sick leave obliged to be settled within 12 months of the reporting date, are recognised in trade and other payables and are measured at the amounts expected to be paid when the liabilities are settled. Benefits falling due more than 12 months after the balance sheet date are discounted to present value. The Group recognises an expense for contributions to the defined contribution pension fund in the period in which the employees render the related service.

Bonus plans

The Group recognises a liability and an expense for bonuses. The Group recognises a liability where contractually obliged or where there is a past practice that has created a constructive obligation. These liabilities are recognised in trade and other payables and are measured at the amounts expected to be paid when the liabilities are settled.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

1. Notes to the financial statements continued

1.2.21 Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

(a) There is a change in contractual terms, other than a renewal or extension of the arrangement;
(b) A renewal option is exercised or extension granted, unless the term of the renewal or extension was initially included in the lease term;
(c) There is a change in the determination of whether fulfilment is dependent on a specific asset; or
(d) There is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios (a), (c) or (d) and at the date of renewal or extension period for scenario (b).

Group as a lessee

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's inception at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding lease obligations, net of finance charges, are included in financial liabilities.

The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each year. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the asset's useful life and the lease term.

Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight line basis over the period of the lease. When the Group is a party to a lease where there is a contingent rental element associated within the agreement, a cost is recognised as and when the contingency materialises.

Group as a lessor

Assets leased out under operating leases are included in investment property. Rental income is recognised on a straight line basis over the lease term. Refer to Note 1.2.7 Investment property for further information on the treatment of investment property.

1.2.22 Revenue

Revenue is measured at fair value of the consideration received or receivable and comprises the fair value for the sale of goods, net of value-added tax, rebates and discounts and after eliminated sales within the Group. The Group assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The Group has concluded that it is acting as principal in all of its revenue arrangements. Revenue is recognised as follows:

Sale of goods

Sales of diamonds and other products are recognised when the significant risks and rewards of ownership have been transferred to the customer and can be measured reliably and receipt of future economic benefits is probable.

Rendering of service

Sales of services are recognised in the accounting period in which the services are rendered, and it is probable that the economic benefits associated with the transaction will flow to the entity, by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Interest income

Interest income is recognised on a time-proportion basis using the effective interest rate method.

1.2.22 Revenue continued

Dividends

Dividends are recognised when the amount of the dividend can be reliably measured and the Group's right to receive payment is established.

1.2.23 Finance costs

Finance costs are generally expensed as incurred, except where they relate to the financing of construction or development of qualifying assets requiring a substantial period of time to prepare for their intended future use. Finance costs are capitalised up to the date when the asset is ready for its intended use.

1.2.24 Dividend distribution

Dividend distributions to the Group's shareholders are recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Group's shareholders.

1.2.25 Critical accounting estimates and judgements

The preparation of the consolidated financial statements requires management to make estimates and judgements and form assumptions that affect the reported amounts of the assets and liabilities, the reported revenue and costs during the periods presented therein, and the disclosure of contingent liabilities at the date of the financial statements. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future and the resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the financial results or the financial position reported in future periods are discussed below.

Life of mine

There are numerous uncertainties inherent in estimating ore reserves and the associated life of mine. Therefore the Group must make a number of assumptions in making those estimations, including assumptions as to the prices of commodities, exchange rates, production costs and recovery rates. Assumptions that are valid at the time of estimation may change significantly when new information becomes available. Changes in the forecast prices of commodities, exchange rates, production costs or recovery rates may change the economic status of ore reserves and may, ultimately, result in the ore reserves being restated. Where assumptions change the life of mine estimates, the associated depreciation rates, residual values, waste stripping and amortisation ratios and environmental provisions are re-assessed to take into account the revised life of mine estimate.

Exploration and evaluation expenditure

This policy requires management to make certain estimates and assumptions as to future events and circumstances, in particular whether economically viable extraction operations are viable where reserves have been discovered and whether indications of impairment exist. Any such estimates and assumptions may change as new information becomes available.

Development expenditure

Judgement is applied by management in determining when a project has reached a stage at which economically recoverable reserves exist and that development may be sanctioned. Management is required to make certain estimates and assumptions similar to those described above for capitalised exploration and evaluation expenditure.

Revenue

Management has entered into arrangements to increase the revenue earned on the sale of rough diamonds. Under these arrangements, revenue is earned for the sale of the rough diamond, with an additional uplift based on the polished margin achieved. These are referred to as partnership arrangements in these financial statements. Management recognises the revenue on the sale of the rough diamond at the point at which it is sold to the third party, as there is no continuing involvement in the cutting and polishing process by management and the significant risks and rewards have passed to the third party. Judgement is applied by management in determining when additional uplift is recognised and measured with regards to rough diamonds sold into partnership arrangements. Management is required to make certain estimates and assumptions based as to when the uplift can be reliably measured.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

1. Notes to the financial statements continued

1.2.25 Critical accounting estimates and judgements continued

Property, plant and equipment – recoverable amount

The calculation of the recoverable amount of an asset requires significant judgements, estimates and assumptions, including future demand, technological changes, exchange rates, interest rates and others.

Impairment of goodwill

The Group determines if goodwill is impaired at least on an annual basis. This requires an estimation of the recoverable amount of the cash-generating unit to which the goodwill relates. Recoverable amount is the higher of fair value less costs to sell and value-in-use. Fair value calculations require the Group to make estimates of the amount for which the cash-generating unit could be sold. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and a market related pre-tax discount rate in order to calculate the present value of those cash flows.

Impairment of assets

The Group assesses each cash-generating unit annually to determine whether any indication of impairment exists. Where an indicator of impairment exists, a formal estimate of the recoverable amount is made, which is considered to be the higher of the fair value less costs to sell and value-in-use. These assessments require the use of estimates and assumptions such as long-term diamond prices, discount rates, future capital requirements, exploration potential and operating performance. Fair value is determined as management's best estimate of the amount that would be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. Fair value for mine assets is generally determined as the present value of estimated future cash flows arising from the continued use of the asset using assumptions that an independent market participant may take into account. Cash flows are discounted by an appropriate discount rate to determine the net present value.

Provision for restoration and rehabilitation

Significant estimates and assumptions are made in determining the amount of the restoration and rehabilitation provisions. These deal with uncertainties such as changes to the legal and regulatory framework, magnitude of possible contamination, and the timing, extent and costs of required restoration and rehabilitation activity.

Taxation

The determination of the Group's obligations and expense for taxes requires an interpretation of tax law and therefore certain assumptions and estimates are made.

Deferred waste

Management is required to make certain estimates and assumptions regarding the tonnes of waste material expected to be mined during the life of area per tonne of ore mined. The average life of area cost per tonne is calculated as the total expected costs to be incurred to mine the ore body divided by the number of tonnes expected to be mined. The average life of area stripping ratio and the average life of area cost per tonne are recalculated annually in light of additional knowledge and changes in estimates. During the current year there was a change in estimate of waste amortisation rates due to the revision of the surveying method used. This resulted in an additional US$1.9 million cost (after tax) being recognised in the income statement. It is not practicable to disclose the effect for the future periods.

Loss of control of the Australian mining activities

Judgement is applied by management in determining whether the Group lost control and if so, on what date control was lost over its Australian mining activities, the Ellendale mine (Kimberley Diamonds Company NL). The Group entered into a sale agreement on 30 November 2012, with an effective date of 31 December 2012. As a result of the terms of the agreement entered into, the Group lost control of Kimberley Diamonds Company NL.

Share based payments

Management applied judgement in determining that the share options relating to the employees of Kimberley Diamonds Company NL were cancelled in light of their leaving status being assessed as "good leavers". The costs not yet recognised in the income statement for the award have been expensed immediately.

1.2.26 Exceptional items

The Group presents as exceptional items on the face of the income statement, those material items of income and expenses which, because of the nature and expected infrequency of the events giving rise to them, merit separate presentation to allow shareholders to understand better the elements of financial performance in the year, so as to facilitate comparison with prior periods and to assess better trends in financial performance.

2. Revenue

	2012 US$'000	2011* US$'000
Sale of goods	**200 700**	305 633
Rendering of services	**1 418**	509
	202 118	306 142

* The prior year figures have been restated for the reclassification impact of accounting for discontinued operations (Refer Note 8, Discontinued Operations).

Finance revenue is reflected in Note 5, Net finance income.

Other operating income is reflected in Note 3, Operating profit.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

3. Operating profit

	2012 US$'000	2011* US$'000
Operating profit includes the following:		
Other operating income		
Profit on disposal of property, plant and equipment – continuing operations	**121**	33
Profit on disposal of property, plant and equipment – discontinued operations	**194**	–
Mark to market revaluations on forward exchange contracts	**1 191**	–
Depreciation, mining asset amortisation and waste amortisation		
Depreciation, mining asset amortisation and waste amortisation – continuing operations	**(47 098)**	(42 848)
Depreciation, mining asset amortisation and waste amortisation – discontinued operations	**(49 984)**	(27 443)
Less: Depreciation capitalised to exploration assets – continuing operations	**1 133**	268
Less: Depreciation and amortisation capitalised to inventory – continuing operations	**416**	33
	(95 533)	(69 990)
Amortisation of intangible assets – continuing operations	**(105)**	–
	(95 638)	(69 990)
Inventories		
Cost of inventories recognised as an expense	**(85 003)**	(97 821)
Foreign exchange gain	**3 815**	6 882
Operating lease expenses as a lessee		
Lease payments recognised in the income statement		
– Mine site property	**(85)**	(87)
– Equipment and service leases	**(45 210)**	(33 178)
– Contingent rental – alluvial deposits	**(7 463)**	(6 153)
– Leased premises	**(792)**	(660)
	(53 550)	(40 078)
Auditor's remuneration – Ernst &Young		
Audit fee		
– Group financial statements	**(1 021)**	(971)
– Continuing operations	**(747)**	(710)
– Discontinued operations	**(274)**	(261)
– Statutory	**(298)**	(249)
– Continuing operations	**(298)**	(249)
	(1 319)	(1 220)
Auditor's remuneration – Other		
– Statutory	**(15)**	–
– Continuing operations	(15)	–
	(15)	–

* The prior year figures have been restated for the reclassification impact of accounting for discontinued operations, unless stated otherwise (Refer Note 8, Discontinued operations).

	2012 US$'000	2011* US$'000
Other non-audit fees – Ernst & Young		
Tax services advisory and consultancy	**(283)**	(61)
– Continuing operations	(112)	(44)
– Discontinued operations	(171)	(17)
Corporate finance services	**(143)**	
– Continuing operations	(143)	–
Tax compliance services	**(16)**	(18)
– Continuing operations	(16)	(18)
Other services	**(150)**	(9)
– Continuing operations	(150)	(6)
– Discontinued operations	**–**	(3)
	(592)	(88)
Other non-audit fees – other		
Other services		
– Internal audit	**(134)**	(225)
– Continuing operations	**(134)**	(225)
– Tax services advisory & consultancy	**(164)**	–
– Continuing operations	**(164)**	–
– Discontinued operations	**–**	–
	(298)	(225)
Employee benefits expense		
Salaries and wages[1]	**(21 124)**	(19 724)

[1]Includes contributions to defined contribution plan of US$0.8million (31 December 2011: US$0.6 million).

Underlying earnings before interest, tax, depreciation and mining asset amortisation (EBITDA)

Underlying EBITDA is shown as the Directors consider this measure to be a relevant guide to the performance of the Group. The reconciliation from operating profit to underlying EBITDA is as follows:

Operating profit	**49 674**	150 526
Foreign exchange gain	**(3 815)**	(6 882)
Share-based payments	**2 281**	1 310
Other operating income	**(1 271)**	(40)
Depreciation and mining asset amortisation (excluding waste amortisation)	**18 582**	21 603
Underlying EBITDA before exceptional items	**65 451**	166 517

* The prior year figures have been restated for the reclassification impact of accounting for discontinued operations (Refer Note 8, Discontinued operations).

Directors' remuneration

Refer to the Directors' remuneration report for full details of transactions with Directors.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

4. Exceptional items

	2012 US$'000	2011* US$'000
Recognised in arriving at operating profit from continuing operations:		
Impairment – Chiri	**14 813**	860
Impairment – Project Kholo	**1 428**	–
	16 241	860

Impairment – Chiri

During 2007, the Company entered into a co-operation agreement and option agreement in relation to the Chiri Concession in Angola, which is a diamondiferous kimberlite. During the current year, the Company terminated its participation in the Chiri project in Angola when it became clear that the terms upon which ongoing participation in this deposit could be secured, did not meet the requirements of the Company for value creation. This resulted in the total resource and development costs expended on the project to date to be written off. The write-off is represented by a loan advanced to the project of US$5.6 million (December 2011: US$5.6 million), costs associated and incurred in securing the option to acquire the indirect interest of US$0.5 million (December 2011: US$0.5 million) and costs associated with the exploration and other associated assets of US$8.7 million (December 2011: US$8.4 million). These costs are not directly related to current operations and are therefore disclosed as exceptional.

Impairment – Project Kholo

During 2011, the Group approved the expansion at the Letšeng mine (Project Kholo). During the current year, Project Kholo as originally envisaged was re-evaluated and, as a result certain capital expenditure incurred on items that were assessed as no longer having an enduring benefit to the operation, were written off. As the write-off of these assets has arisen from circumstances other than the write off of assets at the end of their usual expected lives, this write-off has been classified as exceptional.

5. Net finance income

	2012 US$'000	2011* US$'000
Finance income		
Bank deposits	**2 514**	3 140
Other	**50**	17
Total finance income	**2 564**	3 157
Finance costs		
Bank overdraft	**(123)**	(1)
Interest on debt and borrowings	**(1)**	(1)
Finance costs on unwinding of rehabilitation provision	**(1 128)**	(1 047)
Total finance costs	**(1 252)**	(1 049)
	1 312	2 108

* The prior year figures have been restated for the reclassification impact of accounting for discontinued operations (Refer Note 8, Discontinued operations).

6. Income tax expense

	Notes	2012 US$'000	2011 US$'000
Income statement			
Current			
– Overseas		**(9 860)**	(34 347)
Withholding tax			
– Overseas		**(2 140)**	(8 636)
Deferred			
– Overseas		**(6 407)**	(9 963)
		(18 407)	(52 946)
Reconciliation of tax rate:			
Profit before taxation from continuing operations		**34 745**	152 634
(Loss)/profit before taxation from discontinued operations	8	**(118 686)**	6 228
(Loss)/profit before taxation		**(83 941)**	158 862
		%	%
Applicable income tax rate		**24.5**	26.5
Permanent differences		**9.1**	1.7
Tax impact on exceptional items		**11.5**	–
Unrecognised deferred tax assets		**1.0**	–
Effect of overseas tax at different rates		**0.6**	(1.4)
Effect of deferred tax on unremitted earnings		**–**	1.9
Withholding tax		**6.3**	5.6
Effective income tax rate		**53.0**	34.3
Income tax expense reported in the consolidated income statement		**(18 407)**	(52 946)
Income tax attributable to discontinued operations		**–**	–

* The prior year figures have been restated for the reclassification impact of accounting for discontinued operations (Refer Note 8, Discontinued operations).

7. Disposal of subsidiary

Australia

Kimberley Diamonds Company NL

The Group entered into a sale agreement on 30 November 2012 for the sale of its Australian mining activities, the Ellendale mine (Kimberley Diamonds Company NL), with an effective date of 31 December 2012. As a result of the terms of the agreement entered into, the Group lost control of Kimberley Diamonds Company NL. As a result, the trading results of the operation have been classified as part of discontinued operations. The net assets have been re-measured to fair value, then derecognised and an investment was recorded as an available for sale investment at fair value. The subsidiary has therefore been de-consolidated from this date.

Blina Minerals NL, previously held as an available for sale asset was held through Kimberley and due to the loss of control of Kimberley, the investment in Blina Minerals NL is considered to be disposed of. Due to the decline in share price which was considered to be other than temporary, the investment was fully impaired through profit and loss.

Subsequent to year-end, the Kimberley Diamonds Company NL sale was finalised for the agreed purchase price of US$15.4 million.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

7. Disposal of subsidiary continued

Indonesia

Cempaka mine

During the prior year the Group completed the sale of its Indonesian operation for a consideration of US$5.0 million, resulting in the Group realising a gain of US$2.7 million. Refer to Note 23.3, Cash received/(disposed) from disposal of subsidiary for further detail on the disposal.

The results of the transactions are presented as follows:

	Notes	2012 US$'000	2011 US$'000
Assets			
Property, plant and equipment		**11 001**	2 486
Inventories		**30 891**	132
Trade and other receivables		**3 049**	76
Other financial assets		**13 492**	–
Cash and cash equivalents		**282**	100
Liabilities			
Trade and other payables		**(12 382)**	(308)
Provisions		**(30 964)**	(139)
Net identifiable assets disposed of		**15 369**	2 347
Recycling of foreign currency translation reserve		**48 389**	–
Consideration received		**–**	(5 000)
Available-for-sale investment		**(15 369)**	–
Re-measurement to fair value		**63 697**	–
Loss / (Gain) on disposal of subsidiaries		**112 086**	(2 653)

8. Discontinued operations

The discontinued operations consist of Kimberley Diamonds Company NL (Refer Note 7, Disposal of subsidiary), for the period up until control was lost and the Cempaka mine in Indonesia (Refer Note 7, Disposal of subsidiary) for the period up to 28 October 2011.

Australia

Impairment of property, plant and equipment

Immediately before classification as an asset held-for-sale, the recoverable amount for certain items of property, plant and equipment in Kimberley Diamonds Company NL was estimated and an impairment of US$3.2 million was identified. On reclassification, the carrying value of the assets in the disposal group was re-measured by US$63.7 million to reflect their fair value. The fair value of the asset held-for-sale was determined from the estimated consideration which has been agreed between the Company and a 3rd party buyer, which is US$15.4 million. The results of the Australian operation for the year ended 31 December 2012 and both the Australian and Indonesian operations for the year ended 31 December 2011 are as follows:

	2012 US$'000	2011 US$'000
Revenue	**113 704**	89 432
Cost of sales and other operating costs[1]	**(108 667)**	(82 731)
Gross profit	**5 037**	6 701
Other operating income	**80**	4 043
Royalties and selling costs	**(6 912)**	(5 570)
Finance costs[2]	**(493)**	(278)
Share-based payments	**(650)**	(148)
Impairments[3]	**(4 121)**	(1 767)
Foreign exchange gain	**459**	286
Share of profit in associate	**–**	308
Gain on disposal of subsidiary	**–**	2 653
(Loss)/gain before re-measurement to fair value	**(6 600)**	6 228
Re-measurement to fair value	**(63 697)**	–
Recycling of foreign currency translation reserve	**(48 389)**	–
(Loss)/profit before tax from discontinued operations	**(118 686)**	6 228
Tax expense	**–**	–
– related to current pre-tax loss	**–**	–
(Loss)/profit after tax from discontinued operations	**(118 686)**	6 228
Earnings per share from discontinued operations (cents)		
– Basic	**(86)**	2
– Diluted	**(85)**	2
The net cash flows attributable to the discontinued operations are as follows:		
Operating	**43 007**	(1 136)
Investing	**(51 217)**	1 527
Financing	**–**	(370)
Net cash (outflow)/inflow	**(8 210)**	21

[1] Included in cost of sales is an amount of US$1.7 million relating to write down of inventories (31 December 2011: US$0.4 million).

[2] Included in finance costs is unwinding of discount rate of rehabilitation provision of US$0.95 million (31 December 2011: US$0.87 million)

[3] Included in impairments is the impairment relating to Blina Minerals NL. The Group considered the investment to be impaired due to the significant decline of the investment's share price.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

9. Business combination

On 9 May 2012, Baobab Technologies BVBA (a newly formed 100% held company within Gem Diamonds Investment Limited) acquired certain intellectual property (staff and know-how) from and entered into a short-term lease agreement for the use of equipment and premises with Matrix Diamond Technology BVBA ("Matrix"), an unlisted company based in Belgium, specialising in cutting and polishing of rough diamonds. The cash consideration paid for the intellectual property was US$0.8m. The acquisition was done as part of the Group's sales and marketing strategy and growth in its cutting and polishing business. The final fair value of the assets acquired as at the date of acquisition was:

Final fair value recognition on acquisition	Total (US$'000)
Assets	
Intangible asset	**786**
	786
Purchase consideration in cash transferred	**786**

From the date of acquisition to 31 December 2012, Baobab contributed revenue of US$0.1million and a loss of US$0.4 million to the profit from continuing operations. Had the combination taken place at the beginning of 2012 Baobab would have contributed revenue of US$0.2 and a loss of US$0.6 million.

Transaction costs of US$0.2 million have been expensed and are included in the income statement of the Group.

10. Earnings per share

The following reflects the income and share data used in the basic and diluted earnings per share computations:

	2012 US$'000	2011 US$'000
Profit for the year	**32 579**	99 688
Profit/(loss) for the year from discontinued operations	**(70 297)**	6 228
Recycling of foreign currency translation reserve on discontinued operation	**(48 389)**	–
Less: non-controlling interests	**(15 507)**	(38 247)
Net (loss)/profit attributable to equity holders of the parent for basic and diluted earnings	**(101 614)**	67 669

The weighted average number of shares takes into account the treasury shares at year-end.

Weighted average number of ordinary shares in issue during the year ('000)	**138 177**	138 170

Earnings per share amounts are calculated by dividing the net profit attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share is calculated by dividing the net profit attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year after taking into account future potential conversion and issue rights associated with the ordinary shares.

	Number of shares 2012 ('000)	Number of shares 2011 ('000)
Weighted average number of ordinary shares in issue during the year	**138 177**	138 170
Effect of dilution:		
– Future share awards under the Employee Share Option Programme	**1 350**	2 147
Weighted average number of ordinary shares in issue during the year adjusted for the effect of dilution	**139 527**	140 317

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these financial statements.

11. Property, plant and equipment

As at 31 December 2012	Mining assets[1] (US$'000)	Exploration & development assets (US$'000)	Decommissioning assets (US$'000)	Leasehold improvements (US$'000)	Plant and equipment[2] (US$'000)	Other assets[3] (US$'000)	Total (US$'000)
Cost							
Balance at 1 January 2012	**586 246**	**107 004**	**29 259**	**84 203**	**279 916**	**15 579**	**1 102 207**
Additions	**97 065**	**35 588**	**15 013**	**8 653**	**24 717**	**3 257**	**184 293**
Disposals	**–**	**(17)**	**–**	**(1 180)**	**(3 251)**	**(852)**	**(5 300)**
Disposal of subsidiaries	**(253 149)**	**(39 773)**	**(25 111)**	**(78 039)**	**(174 626)**	**(4 375)**	**(575 073)**
Reclassifications	**–**	**(1 246)**	**–**	**6 291**	**(6 303)**	**1 258**	**–**
Foreign exchange differences	**(11 135)**	**(2 739)**	**(540)**	**37**	**(3 719)**	**(479)**	**(18 575)**
Balance at 31 December 2012	**419 027**	**98 817**	**18 621**	**19 965**	**116 734**	**14 388**	**687 552**
Accumulated depreciation/amortisation							
Balance at 1 January 2012	**370 264**	**38 601**	**12 277**	**69 836**	**176 981**	**9 311**	**677 270**
Depreciation and amortisation charge	**62 168**	**–**	**4 582**	**6 503**	**20 632**	**3 197**	**97 082**
Disposals	**–**	**–**	**–**	**(1)**	**(2 009)**	**(802)**	**(2 812)**
Disposal of subsidiaries	**(227 017)**	**(39 773)**	**(13 979)**	**(66 571)**	**(153 120)**	**(3 077)**	**(503 537)**
Impairment	**1 040**	**7 800**	**–**	**1 852**	**1 910**	**–**	**12 602**
Foreign exchange differences	**(1 641)**	**498**	**1**	**285**	**(598)**	**(203)**	**(1 658)**
Balance at 31 December 2012	**204 814**	**7 126**	**2 881**	**11 904**	**43 796**	**8 426**	**278 947**
Net book value at 31 December 2012	**214 213**	**91 691**	**15 740**	**8 061**	**72 938**	**5 962**	**408 605**

As at 31 December 2011	Mining assets[1] (US$'000)	Exploration & development assets (US$'000)	Decommissioning assets (US$'000)	Leasehold improvements (US$'000)	Plant and equipment[2] (US$'000)	Finance lease assets (US$'000)	Other assets[3] (US$'000)	Total (US$'000)
Cost								
Balance at 1 January 2011	567 320	94 718	22 298	108 371	242 224	991	14 119	1 050 041
Additions	87 232	21 471	8 879	843	26 364	–	3 870	148 659
Disposals	–	–	–	(18)	(3 867)	(956)	(1 347)	(6 188)
Reclassifications	(15 609)	(473)	–	(19 642)	34 803	–	921	–
Foreign exchange differences	(52 697)	(8 712)	(1 918)	(5 351)	(19 608)	(35)	(1 984)	(90 305)
Balance at 31 December 2011	586 246	107 004	29 259	84 203	279 916	–	15 579	1 102 207
Accumulated depreciation/amortisation								
Balance at 1 January 2011	343 435	36 840	10 477	75 482	160 175	991	8 624	636 024
Depreciation and amortisation charge	44 324	–	2 288	3 874	17 670	–	2 133	70 289
Disposals	–	–	–	(18)	(3 804)	(956)	(1 346)	(6 124)
Reclassifications	(3 739)	–	–	(7 194)	10 130	–	803	–
Impairment	–	1 767	–	–	–	–	–	1 767
Foreign exchange differences	(13 756)	(6)	(488)	(2 308)	(7 190)	(35)	(903)	(24 686)
Balance at 31 December 2011	370 264	38 601	12 277	69 836	176 981	–	9 311	677 270
Net book value at 31 December 2011	215 982	68 403	16 982	14 367	102 935	–	6 268	424 937

[1] Included in mining asset is deferred stripping of US$90.9 million (31 December 2011: US$81.3 million)

[2] Included in plant and equipment is capital work in progress of US$47.4 million (31 December 2011: US$31.1 million)

[3] Other assets comprise motor vehicles, computer equipment, furniture and fittings and office equipment

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For the year ended 31 December 2012

12. Investment property

The investment property consists of a commercial unit in a building located in Dubai. It comprises of a unit in Almas Towers in Dubai. The unit is being let out in terms of a long-term rental agreement entered into with a tenant during 2010. The rental agreement was entered into for a period of five years commencing 23 July 2010.

	2012 US$'000	2011 US$'000
Cost		
At 1 January 2012	**617**	617
Net book value 31 December	**617**	617
Accumulated depreciation/impairment	**–**	–
At 1 January 2012	**–**	–
Depreciation	**1**	–
Balance at 31 December 2012	**1**	–
Net book value at 31 December 2012	**616**	617
Fair value[1]	**879**	703
Amounts recognised in profit or loss		
Rental income	**53**	53
Direct operating expenses	**(11)**	(9)

[1] No independent valuation was performed. Fair value was based upon an overview of property sales (units within the same building as the investment property) during 2012, weighted towards the most recent sales activity.

The future minimum rental payments under the long-term rental agreement in aggregate and for each of the following periods are as follows:

	2012 US$'000	2011 US$'000
– Within one year	**56**	54
– After one year but not more than five years	**92**	148
– More than five years	**–**	–
	148	202

13. Intangible assets

As at 31 December 2012	Intangibles[1] (US$'000)	Goodwill (US$'000)	Total (US$'000)
Cost			
Balance at 1 January 2012	–	**104 328**	**104 328**
Disposal of subsidiaries[2]	–	**(33 604)**	**(33 604)**
Additions	**786**	–	**786**
Disposals	–	–	–
Foreign exchange differences	–	**(816)**	**(816)**
Balance at 31 December 2012	**786**	**69 908**	**70 694**
Accumulated amortisation/impairment			
Balance at 1 January 2012	–	**78 799**	**78 799**
Disposal of subsidiaries[2]	–	**(33 604)**	**(33 604)**
Amortisation	**105**	–	**105**
Foreign exchange differences	–	**421**	**421**
Balance at 31 December 2012	**105**	**45 616**	**45 721**
Net book value at 31 December 2012	**681**	**24 292**	**24 973**

[1] Intellectual property was acquired as part of the business combination (Refer Note 9, Business combinations).

[2] The goodwill disposed of related to goodwill in Kimberley which had previously been fully impaired.

As at 31 December 2011	Goodwill (US$'000)	Total (US$'000)
Cost		
Balance at 1 January 2011	109 948	109 948
Foreign exchange differences	(5 620)	(5 620)
Balance at 31 December 2011	104 328	104 328
Accumulated amortisation/impairment		
Balance at 1 January 2011	78 794	78 794
Foreign exchange differences	5	5
Balance at 31 December 2011	78 799	78 799
Net book value at 31 December 2011	25 529	25 529

Impairment of goodwill within the Group was tested in accordance with the Group's policy. Refer to Note 14, Impairment testing for further details.

Notes to the Annual Financial Statements continued

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14. Impairment testing

	2012 US$'000	2011 US$'000
Goodwill		
Goodwill acquired through business combinations has been allocated to the individual cash-generating units, as follows:		
– Letšeng Diamonds	**22 503**	23 648
– Calibrated Diamonds	**1 790**	1 881
Balance at end of the year	**24 293**	25 529

Discount rates are outlined below, and represent the real pre-tax rates. These rates are based on the weighted average cost of capital of the Group and adjusted accordingly at a risk premium of each cash-generating unit, taking into account risks associated with different cash-generating units.

	2012 US$'000	2011 US$'000
Discount rate for each cash-generating unit		
– Letšeng Diamonds	**13.3%**	14.7%
– Calibrated Diamonds	**14.0%**	13.7%

Goodwill impairment testing is undertaken annually and whenever there are indications of impairment. The most recent test was undertaken at 31 December 2012. In assessing whether goodwill has been impaired, the carrying amount of the cash-generating unit is compared with its recoverable amount. For the purpose of goodwill impairment testing in 2012, recoverable amounts for Letšeng Diamonds and Calibrated Diamonds have been determined based on value-in-use.

Letšeng Diamonds

Value-in-use

Cash flows are projected for a period up to the date that mining is expected to cease, based on management's expectations at the time of completing the testing, and is limited to the lesser of the current economic resource or the remaining 12 year mining lease period. This date depends on a number of variables, including recoverable reserves and resources, the forecast selling prices and the treatment costs.

Key assumptions used in the calculations

The key assumptions used in the calculation for goodwill assets are:

- recoverable reserves and resources
- expected carats recoverable
- expected grades achievable
- expected US$/carat prices
- expected plant throughput
- costs of extracting and processing
- discount rates

Economically recoverable reserves and resources, carats recoverable and grades achievable are based on management's current expectation and mine plan, supported by the evaluation work undertaken by appropriately qualified persons.

Long-term US$/carat prices are based on external market consensus forecasts as published by independent marketing consultants adjusted for the Group's specific operations and contracted sales arrangements. Plant throughput is based on current plant facilities and processing capacities. Costs are determined on management's experience and the use of contractors over a period of time whose costs are fairly reasonably determinable.

The foreign exchange rates have been based on current spot exchange rates at the date of the value-in-use calculations.

Sensitivity to changes in assumptions

Given the current volatility in the market, adverse changes in key assumptions could result in changes to impairment charges. The impairment test is most sensitive to changes in commodity prices and foreign exchange rates. The values assigned to these key assumptions reflect past experience.

For the purposes of testing for impairment of goodwill using the value-in-use basis for Letšeng, the excess of the recoverable amount (based on the remaining lease period) over the carrying value is US$110.0 million. Based on the life of mine period using current reserves, the excess over the recoverable amount is US$560.0 million, as it is management's intention to extend the lease arrangement.

No reasonably possible change in any of these key assumptions would cause Letšeng Diamonds' carrying amount to exceed its recoverable amount.

Calibrated Diamonds

The recoverable amount of Calibrated Diamonds was determined based on value-in-use calculation using cash flow projections from financial budgets approved by senior management. The key assumptions include management's best estimate of the recoverability of the residual value of the assets taking into account the location of the assets and the ability to dispose of the assets in the current economic climate.

Sensitivity to changes in assumptions

Given the current volatility in the market, adverse changes in key assumptions could result in changes to impairment charges.

The impairment test is most sensitive to changes in commodity prices and foreign exchange rates. The values assigned to these key assumptions reflect past experience. No reasonably possible change in any of these key assumptions would cause Letšeng Diamonds' carrying amount to exceed its recoverable amount.

Other

Chiri

During the year, the Company terminated its participation in the Chiri project in Angola when it became clear that the terms upon which ongoing participation in this deposit could be secured, did not meet the requirements of the Company for value creation. This resulted in the total resource and developments costs expended on the project to date, to be written off. (Refer to Note 8, Discontinued operations). The write-off is represented by a loan advanced to the project of US$5.6 million (December 2011: US$5.6 million), costs associated and incurred in securing the option to acquire the indirect interest of US$0.5 million (December 2011: US$0.5 million) and costs associated with the exploration and other associated assets of US$8.7 million (December 2011: US$8.4 million). These costs are not directly related to current operations and are therefore disclosed as exceptional.

Project Kholo

Letšeng initiated an expansion programme (Project Kholo) to double current production capacity. This was approved at the Letšeng and the Company's Boards in November 2011. However during 2012 Project Kholo as originally envisaged was re-evaluated. The project management team is actively investigating the optimal allocation of capital to fund an optimised Project Kholo with a lower capital requirement. As work had already commenced on the Project Kholo, some of the costs incurred have been considered to have no future benefit and the cost related to this work has been written off.

The Group will continue to test its other assets for impairment where indications are identified and may in future record additional impairment charges or reverse any impairment charges to the extent that market conditions improve and to the extent permitted by accounting standards.

	2012 US$'000	2011 US$'000
Other non-current assets		
Impairment – Chiri[1]	**14 457**	–
Impairment – Project Kholo[1]	**1 428**	–

[1]Refer Note 4, Exceptional items for a breakdown of the amounts included above.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

15. Other financial assets

	2012 US$'000	2011 US$'000
Non-current		
Environmental bonds[1]	–	7 293
Chiri project loan[2]	–	5 626
Chiri option[2]	–	536
Available-for-sale investment	–	498
Other assets	**14**	634
	14	14 587
Current		
Available-for-sale investment[3]	**15 369**	–
Forward exchange contract	**1 067**	–
Other assets	**8**	9
	16 444	9
	16 458	14 596

[1] Environmental bonds in the prior year related to the Kimberley Diamonds Company NL which has been disposed of. These bonds are classified as loans and receivables.

[2] The Chiri project loan and option in the prior year related to the Chiri concession in Angola which has been fully written off at year-end. Refer Note 14, Impairment testing.

[3] The available for sale investment relating to the Kimberly Diamonds Company NL is classified as a level 3 financial instrument as its fair value is not based on observable market data. Refer Note 8, Discontinued operations.

The available-for-sale investment relates to the investment in Ellendale mine. The Group entered into a sale agreement on 30 November 2012 for the sale of its Australian mining activities, the Ellendale mine (Kimberley Diamonds Company NL), with an effective date of 31 December 2012. As a result of the terms of the agreement entered into, the Group lost control of Kimberley Diamonds Company NL. The trading results of the operation have been classified as part of discontinued operations and the net assets have been derecognised and an investment was recorded as an available for sale investment at fair value.

In the prior year, the non current available-for-sale investment related to Blina Minerals NL which the Group lost control over on loss of control of Kimberley Diamonds Company NL.

The Group has entered into forward exchange contracts to hedge the exposure to changes in foreign currency of future sales of diamonds at Letšeng Diamonds. The forward exchange contract is the revaluation on the mark to market financial assets at year-end. The Group performs no hedge accounting. At December 2012 the Group has Zero Cost Cap Collars in place with a notional cover of US$44.0 million. The zero cost cap collars have a put rate of ZAR8.65 while the call rate starts at ZAR9.17 increasing to ZAR9.52 throughout the year. Of the US$44.0 million collars in place, US$24.0 million were renegotiated and closed subsequent to year-end. These zero cost cap collars have a put rate of ZAR8.85 while the call rate starts at ZAR9.26 increasing to ZAR9.35.

The fair value of these collars at 31 December 2012 was US$1.1 million (31 December 2011 US$nil).

16. Deferred taxation

	2012 US$'000	2011 US$'000
Deferred tax assets		
Accrued leave	**80**	86
Operating lease liability	**–**	5
Provisions	**7 295**	4 730
	7 375	4 821
Deferred tax liabilities		
Property, plant and equipment	**(74 766)**	(68 834)
Prepayments	**(10)**	(10)
Provisions	**162**	–
Unremitted earnings	**(4 038)**	(4 038)
	(78 652)	(72 882)
Net deferred tax liability	**(71 277)**	(68 061)
Reconciliation of deferred tax liability		
Balance at beginning of year	**(68 061)**	(71 012)
Movement in current period:		
– Accelerated depreciation for tax purposes	**(9 447)**	(9 000)
– Accrued leave	**(2)**	25
– Operating lease liability	**(5)**	(15)
– Unremitted earnings	**–**	(2 923)
– Prepayments	**(1)**	(1)
– Provisions	**2 771**	1 750
– Tax losses utilised in the year	**217**	–
– Foreign exchange differences	**3 251**	13 115
Balance at end of year	**(71 277)**	(68 061)

The Group has not recognised a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries because it is able to control the timing of dividends and only part of the temporary difference is expected to reverse in the foreseeable future. The gross temporary difference in respect of the undistributable reserves of the Group's subsidiaries for which a deferred tax liability has not been recognised is US$44.5 million (31 December 2011: US$34.4 million).

The Group has estimated tax losses of US$310.0 million (31 December 2011: US$313.8million). No deferred tax assets have been recognised in respect of such losses at 31 December 2012 as management considers that it is not probable that the losses in those entities will be utilised against taxable profits in those entities in the foreseeable future.

The Group has not recognised deferred tax assets in respect of other deductible temporary differences of US$122.0 million (31 December 2011: US$134.4 million), since management considers that it is not probable that taxable profit will be available against which the deductible temporary differences can be utilised.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

16. Deferred taxation continued

Of the US$310.0 million (31 December 2011: US$313.8million) estimated tax losses, US$1.4 million (31 December 2011: US$0.2 million) losses in various jurisdictions expire as follows:

	31 December 2012 US$'000	31 December 2011 US$'000
2013	**117**	122
2014	**30**	31
2015	**2**	2
2016	**5**	6
2017	**1 224**	–
2018	**–**	–
	1 378	161

17. Inventories

	2012 US$'000	2011* US$'000
Diamonds on hand[1]	**14 247**	21 175
Ore stock piles[1]	**311**	6 197
Consumable stores[1]	**8 094**	11 850
	22 652	39 222

* Significant movement due to the disposal of Kimberley Diamonds Company NL (Refer Note 7, Disposal of subsidiary).

[1] Stated at the lower of cost or net realisable value.

18. Receivables and other assets

	2012 US$'000	2011 US$'000
Trade receivables	**1 858**	1 849
Prepayments	**1 400**	2 620
Deposits	**475**	456
Other receivables	**541**	1 037
VAT receivable	**2 999**	4 183
	7 273	10 145

The carrying amounts above approximate their fair value.

Terms and conditions of the receivables:

These amounts are non-interest bearing and are settled in accordance with terms agreed between the parties.

	2012 US$'000	2011 US$'000
Provision for impairment of receivables*		
Receivables (at nominal value) impaired and fully provided for:	–	1 084
Analysis of receivables		
Neither past due nor impaired	**7 183**	9 875
Past due but not impaired:		
< 30 days	**33**	190
30 – 60 days	**18**	79
60 – 90 days	**39**	1
	7 273	10 145
Total receivables	**7 273**	10 145
Movements in the provision against receivables were as follows:		
Balance at beginning of year	**1 084**	1 149
Charge for the year	–	218
Utilised during the year	**(1 097)**	(61)
Foreign exchange differences	**13**	(222)
Balance at end of year	–	1 084

* The provision for receivables was determined on an individual basis.

19. Cash and short term deposits

	2012 US$'000	2011 US$'000
Cash on hand	**4**	2
Bank balances	**35 754**	62 014
Short term bank deposits	**35 084**	96 734
	70 842	158 750

The amounts reflected in the financial statements approximate fair value.

Cash at banks earn interest at floating rates based on daily bank deposit rates. Short-term deposits are generally call deposit accounts and earn interest at the respective short term deposit rates.

At 31 December 2012, the Group had restricted cash of US$0.2 million (31 December 2011: US$1.6 million).

The Group's cash surpluses are deposited with major financial institutions of high quality credit standing predominantly within Lesotho, Australia, United Kingdom and Switzerland.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

20. Issued capital and reserves

	31 December 2012		31 December 2011	
	Number of shares '000	US$'000	Number of shares '000	US$'000
Authorised – ordinary shares of US$0.01 each				
As at year-end	**200 000**	**2 000**	200 000	2 000
Issued and fully paid				
Balance at beginning of year	**138 267**	**1 383**	138 267	1 383
Allotments during the year	**–**	**–**	–	–
Balance at end of year	**138 267**	**1 383**	138 267	1 383

There were no share transactions during the year.

Share premium

Share premium comprises the excess value recognised from the issue of ordinary shares at par value.

Treasury shares

The Company established an Employee Share Option Plan (ESOP) on 5 February 2007. Under the terms of the ESOP, the Company granted options to employees of over 376 500 ordinary shares with a nil exercise price upon listing.

At Listing, the Gem Diamonds Limited Employee Share Trust acquired 376 500 ordinary shares by subscription from the Company as part of the Initial Awards under the ESOP arrangement at nominal value of US$0.01.

During the year, 10 500 shares were exercised (31 December 2011: 3 000) and no shares lapsed (31 December 2011: 1 000). At 31 December 2012, 80 217 (31 December 2011: 90 717) shares were held by the trust.

	Foreign currency translation reserve US$'000	Share-based equity reserve US$'000	Other reserves US$'000	Total US$'000
Balance at 1 January 2012	**(90 575)**	**42 557**	**(702)**	**(48 720)**
Other comprehensive income	**27 775**	**–**	**702**	**28 477**
Total comprehensive income	**27 775**	**–**	**702**	**28 477**
Share-based payments		**3 113**		**3 113**
Balance at 31 December 2012	**(62 800)**	**45 670**	**–**	**(17 130)**
Balance at 1 January 2011	(39 650)	40 975	–	1 325
Other comprehensive loss	(50 925)	–	(702)	(51 627)
Total comprehensive loss	(50 925)	–	(702)	(51 627)
Share-based payments	–	1 582	–	1 582
Balance at 31 December 2011	(90 575)	42 557	(702)	(48 720)

Foreign currency translation reserve

The foreign currency translation reserve comprises all foreign exchange differences arising from the translation of foreign entities. During the year, the South African, Lesotho, Botswana, Australian, Mauritian and United Arab Emirate subsidiaries' functional currencies were different to the Groups functional currency of US Dollars. The rates used to convert the operating functional currency into US dollars are as follows:

	Currency	2012	2011
Average rate	Maloti to 1 US$	**8.21**	7.26
Period end	Maloti to 1 US$	**8.48**	8.07
Average rate	ZAR to 1 US$	**8.21**	7.26
Period end	ZAR to 1 US$	**8.48**	8.07
Average rate	AUD to 1 US$	**0.97**	0.97
Period end	AUD to 1 US$	**0.96**	0.98
Average rate	Pula to 1 US$	**7.62**	6.84
Period end	Pula to 1 US$	**7.79**	7.47
Average rate	Rupee to 1US$	**30.13**	28.71
Period end	Rupee to 1US$	**30.55**	29.35
Average rate	Dirham to 1 US$	**3.67**	3.67
Period end	Dirham to 1 US$	**3.67**	3.67

Share-based equity reserves

For detail on the share-based payment reserve refer to Note 30, Share-based payments.

Other reserves

In the prior year, at the date of loss of significant influence, the difference between the carrying value and the fair value of the investment in Blina Minerals NL was recognised in profit or loss and subsequent movements in the fair value gave rise to this reserve through other comprehensive income. During the current year Blina Minerals NL was disposed of due to the loss of control in Kimberley Diamonds Company NL. All relevant movements were recognised through other comprehensive income and subsequently recycled through profit and loss.

Non-controlling interests

No non-controlling interests were acquired during the course of the year.

Capital management

For details on capital management, refer to Note 29, Financial risk management.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

21. Trade and other payables

	2012 US$'000	2011 US$'000
Non-current		
Accrued expenses[1]	–	6
Severance pay benefits[2]	**1 007**	661
	1 007	667
Current		
Trade payables[1]	**15 302**	20 091
Accrued expenses[1]	**24 578**	28 427
Leave benefits	**1 236**	2 439
Royalties[1]	**1 445**	4 046
Operating lease	**6**	20
Other	**1 208**	2 075
	43 775	57 098
Total trade and other payables	**44 782**	57 765

The carrying amounts above approximate fair value.

Terms and conditions of the trade and other payables:

[1] These amounts are non-interest bearing and are settled in accordance with terms agreed between the parties.

[2] The severance pay benefits arise due to legislation, within the Lesotho jurisdiction, requiring that two weeks of severance pay be provided for every completed year of service, payable on retirement.

22. Provisions

	2012 US$'000	2011* US$'000
Rehabilitation provisions	**29 496**	41 712
Employee provisions	–	551
Other	–	195
	29 496	42 458

*Significant movement due to the disposal of Kimberley Diamonds Company NL (Refer Note 7, Disposal of subsidiary).

Reconciliation of movement in provisions	Rehabilitation provisions	Employee provisions	Other	Total
Balance at beginning of year	**41 712**	**551**	**195**	**42 458**
Arising during the year	–	**244**	–	**244**
Utilised during the year	**(872)**	–	**(190)**	**(1 062)**
Disposal of subsidiaries	**(30 162)**	**(802)**	–	**(30 964)**
Increase in rehabilitation provisions	**17 749**	–	–	**17 749**
Unwinding of discount rate	**2 077**	–	–	**2 077**
Foreign exchange differences	**(1 008)**	**6**	**(5)**	**(1 007)**
Balance at end of year	**29 496**	–	–	**29 496**

Rehabilitation provisions

The provisions have been recognised as the Group has an obligation for rehabilitation of the mining areas. The provisions have been calculated based on total estimated rehabilitation costs and discounted back to their present values. The pre-tax discount rates are adjusted annually and reflect current market assessments. These costs are expected to be utilised over a life of mine at the mining operation.

Employee provisions

Employee provisions in the prior year relate predominantly to long-service leave entitlements in Australia which were payable upon an employee attaining a certain period of service and other employee benefits.

23. Cash flow notes

23.1 Cash generated by operations

	Notes	2012 US$'000	2011 US$'000
Profit before tax for the year from continuing operations		**34 745**	152 634
(Loss)/ profit before tax for the year from discontinued operations		**(118 686)**	6 228
Adjustments for:			
Depreciation, mining asset amortisation and waste amortisation on property, plant and equipment	3	**95 638**	69 990
Impairment		**19 456**	1 767
Write-down of inventory		**1 650**	391
Finance income		**(3 109)**	(3 786)
Finance costs		**2 291**	1 956
Movement in provisions		**(1 512)**	(548)
Share of profit in associate		**–**	(308)
Unrealised foreign exchange differences		**41 048**	(3 794)
Profit on disposal of property, plant and equipment		**(315)**	(1 772)
Prepayments		**(627)**	1 059
Other non-cash movements		**6 492**	(5 939)
Loss/(gain) on disposal of subsidiaries		**63 697**	(2 653)
Share-based equity transaction		**2 931**	1 455
		143 699	216 680

23.2 Working capital adjustments

	2012 US$'000	2011 US$'000
Increase in inventories	**(24 945)**	(7 197)
Decrease/(increase) in receivables	**565**	(5 677)
(Decrease)/increase in trade and other payables	**(704)**	16 868
	(25 084)	3 994

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

23. Cash flow notes continued

23.3 Cash (disposed)/received from disposal of subsidiary

	2012 US$'000	2011 US$'000
Property, plant and equipment	**11 001**	2 486
Inventories	**30 891**	132
Trade and other receivables	**3 049**	76
Other financial assets	**13 492**	-
Cash and cash equivalents	**282**	100
Trade and other payables	**(12 382)**	(308)
Provisions	**(30 964)**	(139)
	15 369	2 347
Gain on disposal of subsidiaries	**–**	2 653
Proceeds on sale of subsidiaries	**–**	5 000
Proceeds on disposal not yet received	**15 369**	–
Net costs incurred	**(327)**	–
Cash equivalents sold	**(282)**	(100)
Net cash (disposed)/received	**(609)**	4 900

This relates to the disposal of the operations in Australia in the current year and Indonesia in the prior year (Refer Note 7, Disposal of subsidiary).

24. Interest-bearing loans and borrowings

	2012 US$'000	2011 US$'000
Current		
Working capital facility	**2 947**	–

The carrying values of the liabilities approximate their fair values.

At 31 December 2012, the Group, through its subsidiary Letšeng Diamonds, has a M250.0 million revolving working capital facility amounting to US$29.5 million (31 December 2011: US$31.0 million) which was signed in the prior year. As at 31 December 2012 US$2.9 million had been drawn against this facility (31 December 2011: US$nil). The interest rate on this loan is prime less 0.8%, which equated to 8.95% at year-end and interest paid on the outstanding amount was US$0.1 million.

Subsequent to year-end the drawn down amount was fully repaid.

25. Commitments and contingencies

Commitments

Operating lease commitments – Group as lessee

The Group has entered into commercial lease arrangements for rental of office premises. These leases have a period of between two and twelve years with an option of renewal at the end of the period. The terms will be negotiated during the extension option periods catered for in the agreements. There are no restrictions placed upon the lessee by entering into these leases.

Future minimum rentals payable under non-cancellable operating leases:

	2012 US$'000	2011* US$'000
– Within one year	**1 508**	926
– After one year but not more than five years	**6 406**	799
– More than five years[1]	**16 795**	–
	24 709	1 725

[1]During the year Letšeng Diamonds entered into an operating lease contract for the rental of office space relating to the establishment of an in country manufacturing facility in Lesotho.

Mining leases

Mining lease commitments represent the Group's future obligation arising from agreements entered into with local authorities in the mining areas that the Group operates, currently in Lesotho and previously in Lesotho and Australia.

The period of these commitments is determined as the lesser of the term of the agreement, including renewable periods or the life of the mine. The estimated lease obligation regarding the future lease period, accepting stable inflation and exchange rates, is as follows:

	2012 US$'000	2011* US$'000
– Within one year	**88**	86
– After one year but not more than five years	**403**	400
– More than five years	**957**	1 142
	1 448	1 628

Moveable equipment lease

The Group has entered into commercial lease arrangements which include the provision of loading, hauling and other transportation services payable at a fixed rate per tonne of ore and waste mined, and power generator equipment payable based on a consumption basis:

	2012 US$'000	2011* US$'000
– Within one year	**32 774**	34 439
– After one year but not more than five years	**32 767**	68 876
– More than five years	**–**	–
	65 541	103 315

* The prior year figures have been restated for the reclassification impact of accounting for discontinued operations, unless stated otherwise (Refer Note 8, Discontinued operations).

	2012 US$'000	2011* US$'000
Capital expenditure		
Approved but not contracted for	**35 342**	322 705
Approved and contracted for	**22 002**	29 588

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

25. Commitments and contingencies continued

Letšeng initiated an expansion programme (Project Kholo) to double current production capacity. This was approved at the Letšeng and the Company's Boards in November 2011. However during 2012 Project Kholo as originally envisaged was re-evaluated. The project management team is actively investigating the optimal allocation of capital to fund an optimised Project Kholo with a lower capital requirement. As work had already commenced on the Project Kholo, some of the costs incurred have been considered to have no future benefit and the cost related to this work has been written off.

Contingent rentals – alluvial deposits

The contingent rentals on alluvial deposits represents the Group's obligation to third parties for alluvial diamonds mined by such third parties on the Group's mining property. The rental is determined when the actual diamonds mined by such third parties are sold. The rental agreement is based on 40% - 50% of the value of the diamonds recovered by Alluvial Ventures and is limited to US$0.85 million per individual diamond. As at the balance sheet dates, such future sales cannot be determined.

Letšeng Diamonds Educational Fund

In terms of the mining agreement entered into between the Group and the Government of the Kingdom of Lesotho, the Group has an obligation to provide funding for education and training scholarships. The quantum of such funding is at the discretion of the Letšeng Diamonds Education Fund Committee. The amount of the funding provided for the current year was US$0.1 million (31 December 2011: US$0.1 million).

Contingencies

The Group has conducted its operations in the ordinary course of business in accordance with its understanding and interpretation of commercial arrangements and applicable legislation in the countries where the Group has operations. In certain specific transactions however, the relevant third party or authorities could have a different interpretation of those laws and regulations that could lead to contingencies or additional liabilities for the Group. Having consulted professional advisors, the Group has identified possible disputes approximating US$4.1 million (December 2011: US$1.0 million) and tax claims within the various jurisdictions in which the Group operates approximating US$1.4 million (December 2011: US$6.6 million).

There remains a risk that further tax liabilities may potentially arise. While it is difficult to predict the ultimate outcome in some cases, the Group does not anticipate that there will be any material impact on the Group's results, financial position or liquidity.

26. Related parties

Related party	Relationship
Jemax Management (Proprietary) Limited	Common director
Jemax Aviation (Proprietary) Limited	Common director
Gem Diamond Holdings Limited	Common director
Government of Lesotho	Non-controlling interest
Geneva Management Group (UK) Limited	Common director
Blina Minerals NL	Associate (during prior year)

Refer to Note 1.1.2. Operational information, for information regarding shareholding in subsidiaries.

Refer to the Directors' report for information regarding the Directors.

	2012 US$'000	2011 US$'000
Compensation to key management personnel (including Directors)		
Share-based equity transactions	**1 719**	1 186
Short term employee benefits	**9 052**	7 989
	10 771	8 336
Fees paid to related parties		
Jemax Aviation (Proprietary) Limited	**(109)**	(650)
Jemax Management (Proprietary) Limited	**(107)**	(96)
Royalties paid to related parties		
Government of Lesotho	**(16 382)**	(23 887)
Lease and licence payments to related parties		
Government of Lesotho	**(85)**	(87)
Sales to/(purchases) from related parties		
Jemax Aviation (Proprietary) Limited	**200**	451
Geneva Management Group (UK) Limited	**(13)**	(10)
Blina Minerals NL	**–**	413
Amount included in trade receivables owing by/(to) related parties		
Jemax Aviation (Proprietary) Limited	**51**	(50)
Jemax Management (Proprietary) Limited	**(9)**	(9)
Amounts owing by/(to) related party		
Government of Lesotho	**(1 062)**	(2 012)
Blina Minerals NL[1]	**372**	366
Dividends paid		
Government of Lesotho	**(8 770)**	(36 654)

[1] The amount owing by Blina Minerals NL has been fully written off. Refer Note 7, Disposal of subsidiary.

Compensation to key management personnel (including Directors) includes compensation relating to Kimberley Diamonds Company which is included as part of discontinued operations.

Jemax Management (Proprietary) Limited and Jemax Aviation (Proprietary) Limited provided administrative and aviation services with regards to the mining and evaluation activities undertaken by the Group. The above transactions were made on terms agreed between the parties.

Geneva Management Group (UK) Limited provided administration, secretarial and accounting services to the Company. The above transactions were made on terms that prevail in arm's length transactions.

27. Post balance sheet events

The following has taken place since the balance sheet date:

- The Company concluded and signed a US$20 million three-year unsecured revolving credit facility with Nedbank Capital (a division of Nedbank Ltd), which is available for draw-down.
- As at the 31 December 2012 US$2.9 million of the Letšeng facility which was drawn down was repaid in January 2013.
- On 31 January 2013 the Group concluded the sale of Kimberley Diamond Company NL with an effective date of 31 December 2012.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

28. Financial instruments

Fair value

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments that are carried in the financial statements:

	Carrying amount		Fair value	
	2012 US$'000	2011 US$'000	2012 US$'000	2011 US$'000
Financial assets				
Cash	**70 842**	158 750	**70 842**	158 750
Loan notes[1]	–	5 626	–	5 626
Receivables[1]	**7 273**	10 145	**7 273**	10 145
Environmental bond facilities and bank guarantees	–	7 293	–	7 293
Other loans[1]	**22**	32	**22**	32
Chiri option[2]	–	536	–	n/a
Available-for-sale investments[3]	**15 369**	498	**15 369**	498
Forward exchange contract	**1 067**	–	**1 067**	–
Financial liabilities				
Bank overdraft	**29**	–	**29**	–
Interest bearing loans and borrowings	**2 947**	–	**2 947**	–
Trade and other payables[1]	**44 782**	57 765	**44 782**	57 765

[1] The fair value approximates carrying value.

[2] The option is carried at cost as fair value cannot be determined.

[3] The available for sale investment relating to Kimberley Diamonds Company NL is classified as a level 3 financial instrument as the determined fair value is not based on observable market data

The fair values of other financial assets have been calculated using market interest rates where applicable.

29. Financial risk management

Financial risk factors

The Group's activities expose it to a variety of financial risks:

(a) Market risk (including commodity price risk and foreign exchange risk);

(b) Credit risk;

(c) Liquidity risk; and

The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance.

Risk management is carried out under policies approved by the Board of Directors. The Board provides principles for overall risk management, as well as policies covering specific areas, such as foreign exchange risk, interest-rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investing excess liquidity.

There have been no changes in the financial risk management policy since the prior year.

29. Financial risk management continued

Capital management

The capital of the Company is the issued share capital, share premium and treasury shares on the Group's balance sheet. The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximise shareholder value. The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may issue new shares. The management of the Group's capital is performed by the Board. During November 2011, the Group, through its subsidiary Letšeng, signed a Maloti 250.0 million (31 December 2012: US$29.5 million, 31 December 2011: US$31.0 million) three-year revolving working capital facility of which US$2.9 million had been drawn down as at year-end. In addition to this, and by reference to the Note 27, Post balance sheet events, the Company concluded and signed a US$20 million 3-year unsecured revolving credit facility with Nedbank Capital (a division of Nedbank Ltd), which is available for draw-down. At present, the Group has US$49.5 million (31 December 2011: US$31.0 million) of funding available and has the flexibility to manage the capital structure more efficiently by the introduction of debt into the Group to ensure that an appropriate gearing ratio is achieved.

(a) Market risk

(i) Commodity price risk

The Group is subject to commodity price risk. Diamonds are not a homogenous product and the price of rough diamonds is not monitored on a public index system. The fluctuation of prices is related to certain features of diamonds such as quality and size. Diamond prices are marketed in US$ and long-term US$/carat prices are based on external market consensus forecasts and contracted sales arrangements adjusted for the Group's specific operations. The Group does not have any financial instruments that may fluctuate as a result of commodity price movements.

Kimberley Diamonds had an existing supply agreement with a top-end jeweller for its fancy yellow diamond production. This contract, which catered for a monthly price review, was for the life of the mine and provided certainty to the revenue flows (Refer Note 8, Discontinued operations).

(ii) Foreign exchange risk

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the Lesotho Loti, South African Rand and Australian Dollar. Foreign exchange risk arises when future commercial transactions, recognised assets and liabilities are denominated in a currency that is not the entity's functional currency.

The Group's sales are denominated in US$ which is the functional currency of the Company, but not the functional currency of the operations.

The currency sensitivity analysis below is based on the following assumptions:

- Differences resulting from the translation of the financial statements of the subsidiaries into the Group's presentation currency of US$, are not taken into consideration.
- The major currency exposures for the Group relate to the US$ and local currencies of subsidiaries. Foreign currency exposures between two currencies where one is not the US$ are deemed insignificant to the Group and have therefore been excluded from the sensitivity analysis.

The analysis of the currency risk arises because of financial instruments denominated in a currency that is not the functional currency of the relevant Group entity. The sensitivity has been based on financial assets and liabilities at 31 December 2012. There has been no change in the assumptions or method applied from the prior year.

Sensitivity analysis

If the US$ had appreciated (depreciated) 10% against currencies significant to the Group at 31 December 2012, income before taxation would have been US$0.5 million higher (lower) (31 December 2011: US$-). There would be no effect on equity reserves other than those directly related to income statement movements.

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

29. Financial risk management continued

(iii) Forward exchange contracts

The Group has entered into forward exchange contracts to hedge the exposure to changes in foreign currency of future sales of diamonds at Letšeng. The Group performs no hedge accounting. At December 2012 the Group has zero cost cap collars in place with a notional cover of US$44.0 million. The zero cost cap collars have a put rate of ZAR8.65 while the call rate starts at ZAR9.17 increasing to ZAR9.52 throughout the year. Of the US$44.0 million collars in place, US$24.0 million were renegotiated and closed subsequent to year end. These zero cost cap collars have a put rate of ZAR8.85 while the call rate starts at ZAR9.36 increasing to ZAR9.35.

(iv) Cash flow interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group's cash flow interest rate risk arises from borrowings. Borrowings issued at variable rates expose the Group to cash flow interest rate risk. At the time of taking new loans or borrowings management uses its judgment to decide whether it believes that a fixed or variable rate borrowing would be more favourable to the Group over the expected period until maturity. An analysis has been prepared which demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's profit before tax (through impact on floating rate borrowings).

The interest rate sensitivity analysis is based on the following assumptions:

- All non-derivative financial instruments with fixed interest rate terms that are carried at amortised cost are excluded from this analysis. This is because a change in market interest rates for such non-derivative financial instruments would only affect income if these are measured at their air value; and
- The Group does not have significant cash flow hedges related to interest rate risk. As such, movements that would occur in equity as a result of a hypothetical change in interest rates at reporting date has been excluded from this analysis.

Sensitivity analysis

If interest rates had increased (decreased) by 100 basis points at 31 December 2012 there would have been no material impact on profit in the current year due to the low level of debt of US$2.9 million. There would be no effect on equity reserves other than those directly related to income statement movements.

(b) Credit risk

The Group's potential concentration of credit risk consists mainly of cash deposits with banks and other receivables. The Group's short-term cash surpluses are placed with the banks that have investment grade ratings. The maximum credit risk exposure relating to financial assets is represented by the carrying value as at the balance sheet dates. The Group considers the credit standing of counterparties when making deposits to manage the credit risk.

Considering the nature of the Group's ultimate customers and the relevant terms and conditions entered into with such customers, the Group believes that credit risk is limited as customers pay on receipt of goods. No other financial assets are impaired or past due and accordingly, no additional analysis has been provided. No collateral is held in respect of the impaired receivables or receivables that are past due but not impaired.

(c) Liquidity risk

Liquidity risk arises from the Group's inability to obtain the funds it requires to comply with its commitments including the inability to sell a financial asset quickly at a price close to its fair value. Management manages the risk by maintaining sufficient cash, marketable securities and ensuring access to shareholding funding. This ensures flexibility in maintaining business operations and maximises opportunities. Furthermore, subsequent to year end, the Company concluded and signed a US$20 million 3-year unsecured revolving credit facility, which is available for draw-down. This facility, together with the Maloti 250 million (US$29.5 million) facility signed by Letšeng in November 2011, provides the Group with a total of US$49.5 million available debt facilities.

The table below summarises the maturity profile of the Group's financial liabilities at 31 December based on contractual undiscounted payments:

	2012 US$'000	2011 US$'000
Floating interest rates		
Trade and other payables		
– Within one year	**2 947**	–
– After one year but not more than five years	**–**	–
– More than five years	**–**	–
Total	**2 947**	–
Trade and other payables		
– Within one year	**43 775**	57 098
– After one year but not more than five years	**1 007**	667
– More than five years		–
Total	**44 782**	57 765

30. Share-based payments

The expense recognised for employee services received during the year is shown in the following table (US$'000):

	2012 US$'000	2011* US$'000
Equity-settled share-based payment transactions charged to the Income statement – continuing operations	**2 281**	1 310
Equity-settled share-based payment transactions charged to the Income statement – discontinued operations (Refer Note 8, Discontinued operations) [1]	**650**	148
Equity-settled share-based payment transactions capitalised	**182**	124
	3 113	1 582

* The prior year figures have been restated for the reclassification impact of accounting for discontinued operations (Refer Note 8, Discontinued operations).

[1] Included in this expense is the cost of accelerated vesting for the Australian employees. The equity settled awards were forfeited from the scheme which has resulted in the future SBP charges being accelerated from the applicable Employee Share Option Plan ("ESOP"). Excluded from this acceleration is the ESOP awarded on 11 September 2012. This expense is reversed as the vesting relates to an 'employment period' and is not based on market conditions.

The long-term incentive plans are described below:

Employee Share Option Plan

Certain key employees are entitled to a grant of options, under the Employee Share Option Plan ('ESOP') of the Company. The vesting of the options is dependent on employees remaining in service for a prescribed period (normally three years) from the date of grant. The fair value of share options granted is estimated at the date of the grant using a Black Scholes simulation model, taking into account the terms and conditions upon which the options were granted. It takes into account projected dividends and share price fluctuation co-variances of the Company.

There is a nil or nominal exercise price for the options granted at Admission of Gem Diamonds Limited. The contractual life of the options is ten years and there are no cash settlement alternatives. The Group has no past practice of cash settlement.

Performance shares

No performance shares were granted during the year. During 2008, 437 769 performance shares were granted to certain key employees under the ESOP of the Company in four tranches. The vesting of awards is subject to the satisfaction of performance conditions over a three-year period that is considered appropriately stretching. If the performance conditions are not met the options lapse. The fair value of share options granted is estimated at the date of the grant using a Monte Carlo simulation model, taking into account the terms and conditions upon which the options were granted,

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

30. Share-based payments continued

projected dividends, share price fluctuations, the expected volatility, the risk-free interest rate, expected life of the option in years and the weighted average share price of the Company. The contractual life of each option granted is three years. The performance share awards vested in April 2011. For the purpose of the performance criterion, the conditions were tested and the outcome was that no awards vested as neither the diamond peer group nor the FTSE 250 was outperformed.

Non-Executive share awards

In order to align the interests of the Chairman and independent Directors with those of the shareholders, the non-Executive Directors were invited to subscribe for shares at nominal value on terms set out in the prospectus. The non-Executive Directors shall not be eligible to participate in the STIBS, ESOP or ESGP or any other performance-related incentive arrangements which may be introduced by the Company from time to time. There are currently no non-Executive share awards.

Employee Share Option Plan for 2010 (long-term incentive plan (LTIP))

On 23 June 2010, 1 375 200 options were granted to certain key employees under the LTIP of the Company. Of the total number of shares, 458 400 were Nil Value Options and 916 800 were Market Value Options. The exercise price of the Market Value Options is £2.31 (US$3.33), which was equal to the market price of the shares on the date of the grant. The vesting of the options will be subject to the satisfaction of performance conditions over a three-year period that is considered appropriately stretching. If the performance conditions are not met the options lapse. The fair value of the options granted is estimated at the date of the grant using a Monte Carlo simulation model, taking into account the terms and conditions upon which the options were granted, projected dividends, share price fluctuations, the expected volatility, the risk-free interest rate, expected life of the options in years and the weighted average share price of the Company. The contractual life of each option granted is three years. There are no cash settlement options.

Employee Share Option Plan for 2011 (long-term incentive plan (LTIP))

On 13 June 2011, 1 314 000 options were granted to certain key employees under the LTIP of the Company. Of the total number of shares, 438 000 were Nil Value Options and 876 000 were Market Value Options. The exercise price of the Market Value Options is £2.63 (US$4.38), which was equal to the market price of the shares on the date of the grant. The vesting of the options will be subject to the same conditions as the LTIP 2010 above.

Employee Share Option Plan for March 2012 (long-term incentive plan (LTIP))

On 20 March 2012, 1 347 000 options were granted to certain key employees under the LTIP of the Company. Of the total number of shares, 449 000 were Nil Value Options and 898 000 were Market Value Options. The exercise price of the Market Value Options is £3.00 (US$ 4.76), which was equal to the market price of the shares on the date of the grant. The vesting of the options will be subject to the same conditions as the LTIP 2010 above.

Employee Share Option Plan for September 2012 (long-term incentive plan (LTIP))

On 11 September 2012, a further 936 000 options were granted to certain key employees under the LTIP of the Company. Of the total number of shares 312 000 were Nil Value Options and 624 000 were Market Value Options. The exercise price of the Market Value Options is £1.78 (US$2.95), which was equal to the market price of the shares on the date of grant. The vesting of the September 2012 options is subject to performance conditions based on goals relating to company and individual performance which are classified as non-market conditions. The fair value of these options is estimated in a similar manner as the LTIP 2010 above.

Movements in the year

Employee Share Option Plan

The following table illustrates the number and movement in, share options during the year:

	2012 '000	2011 '000
Outstanding at beginning of year	**44**	47
Exercised during the year	**(11)**	(3)
Balance at end of year	**33**	44
Exercisable at end of year	**–**	–

The following table lists the inputs to the model used for the plan for the awards granted in 2008:

Employee Share Option Plan	
Dividend yield (%)	–
Expected volatility (%)	22
Risk-free interest rate (%)	5
Expected life of option (years)	10
Weighted average share price	18.28
Model used	Black Scholes

The fair value of share options granted is estimated at the date of the grant using a Black Scholes simulation model, taking into account the terms and conditions upon which the options were granted, projected dividends, share price fluctuations, the expected volatility, the risk-free interest rate, expected life of the option in years and the weighted average share price of the Company.

The ESOP is an equity-settled plan and the fair value is measured at the grant date.

Performance shares

The performance shares vested in April 2011 without meeting the performance conditions. All share options were forfeited. The following table illustrates the number ('000) and movement in share options during the year:

	2012 US$'000	2011 US$'000
Outstanding at beginning of year	**–**	319
Forfeited during the year	**–**	(319)
Balance at end of year	**–**	–
Exercisable at end of year	**–**	–

Notes to the Annual Financial Statements continued

For the year ended 31 December 2012

30. Share-based payments continued

The following table lists the inputs to the model used for the four tranches of the performance share awards:

Performance Share Awards	Tranche 1	Tranche 2	Tranche 3	Tranche 4
Award date	30/04/2008	09/06/2008	01/07/2008	02/12/2008
Dividend yield (%)	–	–	–	–
Expected volatility (%)	30.58	31.32	31.23	74.18
Risk-free interest rate (%)	2.49	2.98	2.92	1.13
Expected life of option (years)	3.00	3.00	3.00	3.00
Weighted average share price	13.60	20.34	20.51	3.96
Model used	Monte Carlo	Monte Carlo	Monte Carlo	Monte Carlo

The fair value of share options granted is estimated at the date of the grant using a Monte Carlo simulation model, taking into account the terms and conditions upon which the options were granted, projected dividends, share price fluctuations, the expected volatility, the risk-free interest rate, expected life of the option in years and the weighted average share price of the Company.

The ESOP is an equity-settled plan and the fair value is measured at the grant date.

Employee Share Option Plan for 2012 and 2011 (long-term incentive plan (LTIP))

The following table illustrates the number ('000) and movement in the ESOP 2012 and 2011 share options during the year:

	2012	2011
Outstanding at beginning of year	**2 467**	1 375
Granted during the year	**2 283**	1 314
Forfeited	**(249)**	(222)
Balance at end of year	**4 501**	2 467
Exercisable at end of year	**–**	–

The following table lists the inputs to the model used for the plan for the awards granted during the current and prior year:

	LTIP September 2012	LTIP March 2012	LTIP 2011	LTIP 2010
Employee Share Option Plan				
Dividend yield (%)	**–**	**–**	–	–
Expected volatility (%)	**42.10**	**63.88**	66.32	76.33
Risk-free interest rate (%)	**0.33**	**1.20**	1.59	1.11
Expected life of option (years)	**3.00**	**3.00**	3.00	3.00
Weighted average share price(US$)	**2.85**	**4.76**	4.38	3.33
Fair value of Nil Value Options (US$)	**2.85**	**3.76**	3.01	2.27
Fair value of Market Value Options (US$)	**1.66**	**2.27**	1.95	1.45
Model used	**Monte Carlo**	**Monte Carlo**	Monte Carlo	Monte Carlo

The fair value of share options granted is estimated at the date of the grant using a Monte Carlo simulation model, taking into account the terms and conditions upon which the options were granted, projected dividends, share price fluctuations, the expected volatility, the risk-free interest rate, expected life of the option in years and the weighted average share price of the Company.

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For the year ended 31 December 2012

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Notes

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