



22 October 2018

ASX Limited
20 Bridge Street
Sydney NSW 2000

Dear Cheng

Financial Condition Query

The Company refers to your letter of 9 October 2018 and responds as follows:

1. The loan agreement was verbally approved by the independent directors. Mr MZ Gutnick was the Chairman and Managing Directors at the time, was in the office, and therefore signed the document.
2. It is more beneficial for Merlin to treat the amount as a loan rather than payment for services. Merlin balances its cash requirements between the need for funds for mining, development, exploration and working capital needs which ensures that the services required from external sources are balanced. Merlin sees the services provided by AXIS as critical to its ongoing needs. Merlin is aware that staff of AXIS has been instrumental in raising over \$60 million capital for Merlin since 2009 and managing the affairs of Merlin since that time, which has included bringing Merlin back into diamond production, and more recently, the ongoing development of a diamond sales arm in Belgium.
3. Yes.
4. It needs to continue to utilise the services of AXIS which has the personnel and equipment to manage the activities of Merlin – Merlin does not have such personnel and equipment. It should be noted that according to annual reports of other companies that AXIS has provided services too, AXIS has provided similar management and geological services to many companies for 30 years, for instance, Great Central Mines Limited.
5. N/A
6. The information is disclosed in the related party note. Please be aware that in the earlier, years it was netted with other items. We also note that the audited annual reports have been presented to shareholders at the annual general meetings and shareholders have not expressed any concerns at the contents of the annual reports. The repayments are not specifically categorised as principal or interest as interest is accrued to the balance of the account and therefore the repayment is credited to the balance. However, the attached is a dissection of the repayments.

	Repayment	Interest	Principal
Fiscal 2012	\$200,000	\$19,053	\$180,947
Fiscal 2013	\$1,327,242	\$205,368	\$1,121,874
Fiscal 2014	\$2,442,300	\$444,926	\$1,997,374
Fiscal 2015	\$1,211,505	\$626,469	\$585,036
Fiscal 2016	\$898,913	\$791,184	\$107,729
Fiscal 2017	\$1,210,000	\$924,636	\$285,364
Fiscal 2018	\$nil	\$nil	\$nil

7. Merlin typically receives a verbal request for drawdown. AXIS staff makes Merlin generally aware of the nature of the costs to be covered by the drawdown. Merlin will then consider whether it should agree to the drawdown and if it does agree to it, Merlin will prepare a cheque requisition for the amount of drawdown and it is signed by either a director or senior person. If it does not agree to the drawdown, it will verbally advise AXIS staff.

8. The Company will discuss the question of what further information its current auditors require to enable them to issue an unqualified audit opinion on the loan balance. Merlin wishes to point out that its previous auditors required the Company to provide for the balance of the loan account and on that basis issued an unqualified audit report on this point. The current auditors take a different view on the loan balance and hence the qualification.

9. The Company's responses have been approved and authorised by the Board of Directors.

If you require any further information, please do not hesitate to contact us.

Merlin Diamonds Limited



17 October 2018

Mr Peter Lee

Company Secretary

By email: peterl@axisc.com.au

Dear Mr Lee

Merlin Diamonds Limited (“MED”): Financial Condition Query

ASX Limited (“ASX”) refers to the following:

- A. MED’s Full Year Statutory Accounts for the year ended 30 June 2018 lodged on the ASX Market Announcements Platform and released at 8:59 am on 8 October 2018 (the “Annual Report”).
- B. ASX’s query letter dated 9 October 2018 and MED’s response to the query letter dated 15 October 2018.
- C. The loan agreement between AXIS Consultants Pty Ltd (“AXIS”) and MED.

ASX notes that to several of ASX’s queries, MED responded:

“The Company does not have access to financial information of AXIS. From a search of AXIS, AXIS is not a reporting entity. Accordingly on a conservative basis, the Company has provided for the loan as a doubtful debt.”

ASX notes that whereas Mr. MZ Gutnick signed the loan agreement on behalf of MED and Mr Peter Lee signed the loan agreement on behalf of AXIS, both Mr MZ Gutnick and Mr Lee are each a director or employee of MED and AXIS. Further, the loan agreement states that both MED and AXIS are registered at the same address at Level 1A, 42 Moray Street, Southbank. ASX’s interpretation is that MED and AXIS are related parties.

ASX has the following further queries:

1. Why did Mr MZ Gutnick enter into the loan agreement on behalf of MED instead of someone independent of AXIS?
2. In MED’s response it states: *“AXIS provides management and geological services to MED”*. Why are the funds advanced to AXIS in the form of a loan, rather than paid as an expense for the services provided?
3. Given MED does not have sufficient information about its related party, AXIS to be satisfied it has the capacity to repay loans made on an unsecured basis, does MED intend to continue to lend to AXIS?
4. If the answer to question 3 is ‘yes’, why?
5. If the answer to question 3 is ‘no’, what alternative arrangements does MED intend to pursue to fund its operations?
6. Where in the Annual Report or in past annual reports does it state that AXIS has made repayments pursuant to the loan? Please detail in your response the total amount repaid by AXIS over the life of the loan split into financial years and between loan principle and interest.
7. Please detail the process and authorities required for MED to respond to a drawdown notice from AXIS. What documentation does MED require and keep on file in relation to a drawdown?

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8. Please provide a further response to the question, what steps does MED intend to take to obtain an unqualified audit/review report for future financial periods, specifically in relation to the audit qualification of the loan balance.
 9. Please confirm that MED's responses to the questions above have been authorised and approved in accordance with its published continuous disclosure policy or otherwise by its board or an officer of MED with delegated authority from the board to respond to ASX on disclosure matters.

When and where to send your response

This request is made under, and in accordance with, Listing Rule 18.7. Your response is required as soon as reasonably possible and, in any event, by not later than half an hour before the start of trading (ie before 9.30 a.m. AEST) on Monday, 22 October 2018.

ASX reserves the right to release a copy of this letter and your response on the ASX Market Announcements Platform under Listing Rule 18.7A. Accordingly, your response should be in a form suitable for release to the market.

Your response should be sent to me by e-mail. It should not be sent directly to the ASX Market Announcements Office. This is to allow me to review your response to confirm that it is in a form appropriate for release to the market, before it is published on the ASX Market Announcements Platform.

If you have any queries or concerns about any of the above, please contact me immediately.

Yours sincerely

[Sent electronically without signature]

Cheng Tang

Senior Adviser, Listings Compliance (Melbourne)



15 October 2018

ASX Limited
20 Bridge Street
Sydney NSW 2000

Dear Cheng

Financial Condition Query

The Company refers to your letter of 9 October 2018 and responds as follows:

1. The Directors confirm that in their opinion, the Annual Report:
 - a) complies with the relevant Accounting Standards; and
 - b) give a true and fair view of the financial performance and financial position of MED.

2.
 - a) ASX have asked “why is MED unable to provide its auditors with the formal loan agreement or any other documentation in relation to the loan receivable”. The question asked by ASX is not a true representation of the wording of the audit report. The audit report states “We have been unable to obtain sufficient appropriate audit evidence in respect to the collectability or otherwise of this amount”. The Company has made available to the auditors all information it has in respect to the loan including the formal loan agreement. Unfortunately, this was not sufficient for the auditors.
 - b) The Company does not have access to financial information of AXIS. From a search of AXIS, AXIS is not a reporting entity. Accordingly on a conservative basis, the Company has provided for the loan as a doubtful debt.
 - c) The Company does not have access to financial information of AXIS. From a search of AXIS, AXIS is not a reporting entity. Accordingly on a conservative basis, the Company has provided for the loan as a doubtful debt.
 - d) AXIS provides management and geological services to MED. AXIS has built up specialised knowledge in the mining and exploration industry including detailed knowledge of diamonds. It has also built up knowledge of the markets for the sale of diamonds internationally and has access to those markets. Pursuant to the Service Agreement, AXIS has performed such functions as payroll, maintaining employee records required by law and by usual accounting procedures, providing insurance, human resources, company secretarial, land management, certain exploration and

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mining support in the form of providing project managers, exploration managers, environmental officers, geologists, field assistants, safety personnel; financial, accounting advice and services. It also provides for the Company various services, including but not limited to the making available of office supplies, office facilities and any other services as may be required from time to time by the Company as and when requested by the Company. The Company has provided loan funds to ensure the services are still available to the Company.

- e) At the current time for the reasons set out on question 2(b), the Company is not in a position to determine whether AXIS will repay the loan in June 2020.
 - f) AXIS provides management and geological services to MED. AXIS has built up specialised knowledge in the mining and exploration industry including detailed knowledge of diamonds. It has also built up knowledge of the markets for the sale of diamonds internationally and has access to those markets. Pursuant to the Service Agreement, AXIS has performed such functions as payroll, maintaining employee records required by law and by usual accounting procedures, providing insurance, human resources, company secretarial, land management, certain exploration and mining support in the form of providing project managers, exploration managers, environmental officers, geologists, field assistants, safety personnel; financial, accounting advice and services. It also provides for the Company various services, including but not limited to the making available of office supplies, office facilities and any other services as may be required from time to time by the Company as and when requested by the Company.
 - g) Yes. The information you have requested is detailed in the audited annual report each year. AXIS has made repayments in each fiscal year other than fiscal 2018.
 - h) The Company does not have access to financial information of AXIS. From a search of AXIS, AXIS is not a reporting entity. Accordingly on a conservative basis, the Company has provided for the loan as a doubtful debt.
3. The Company provided evidence to the auditors of the quantity of diamond stock on hand at 30 June 2018. The evidence that was provided to the auditors was not sufficient for their purposes. It is noted that the auditors did not request a stocktake at 30 June 2018 and had not raised the issue of a stocktake or alternative method of confirming the quantity of diamond inventory at 30 June 2018 prior to the balance date. The first time the auditors raised the question of inventory was after the balance date. As such any opportunity for the Company to substantiate the diamond inventory at 30 June 2018 was lost.

In terms of the valuation, there are two components to the diamond valuation – rough diamonds and polished diamonds. In terms of the polished diamonds, the Company provided a written valuation to the auditors from an international expert in the diamond field. In terms of the rough diamonds, the Company undertook an internal valuation based on the value attributed to the diamonds from the feasibility study and discounted that value. Subsequent to that internal valuation, the Company has sold some of the rough diamonds (including from production from July and part of August 2018) and have received \$468,894.

4. The Company and the auditors have already agreed that further discussions are required between the parties to determine a process that will satisfy the auditors of both the quantity and valuation at a balance date. It is the Company's initial thoughts that the diamond stock at balance date will be sent to Antwerp for sale immediately after balance date with the sale being undertaken promptly; such that the proceeds be received promptly thus allowing the auditors to rely on this process for both the quantity on hand at balance date and confirmation of the proceeds.
5. Yes
6. N/A
7. Yes
8. Yes. The Directors refer you to the Reports for the quarters ended 31 December 2017, 31 March 2018 and 30 June 2018 together with the announcements to ASX from 1 September 2017 to the current date which set a detailed description of the activities of the Company through the development and re-commencement of mining and processing operations at the Merlin diamond mine.
9. Yes
10. As set out in note 30 to the financial statements at 30 June 2018, subsequent to balance date, the Company has raised \$2,771,000 through the issue of convertible notes and notes, proceeds from the sale of part of the inventory of diamonds and received GST refunds; and issued shares to the value of \$750,000 as result of the conversion of convertible notes. As announced on 3 September 2018, the Company has entered into a \$2 million note facility with Cuart Investments Limited to provide funding for its Merlin diamond mine in the Northern Territory. The facility can be drawn down in 3 tranches of which the first tranche has been drawn. It has also entered into a convertible note agreement for up to \$2.5 million with Edensor Holdings Pty Ltd, subject to receiving shareholder approval which was received on 27 September 2018.

Since the date of the financial statements, convertible notes to the value of \$518,000 have been converted into ordinary shares. The Company understands that a number of other convertible note and noteholders intend to convert their convertible notes and notes into ordinary shares.

Each of these steps set out above either strengthens the assets or reduces the liabilities of the company, thus improving the balance sheet. Equally, as referred to in the financial statements and as set out above, the company has sold part of its diamond inventory and the remaining part of the diamond inventory is expected to be sold shortly. The rough diamonds have come from production from May to mid-August 2018 and recovery of diamonds at Merlin continues as operations continue at the Merlin diamond mine.

As also disclosed in the financial statements for the past few years, the Company has a track record of raising capital to sustain its operations and there is no reason to believe that it will not be able to continue to raise capital in the future.

The Directors note that the financial position of the Company is not dis-similar to most companies in the exploration/development stage with the need to continue to raise capital to sustain operations until steady stage operations are reached.

11.N/A

12.The Company believes it is in compliance with Listing Rules 3.1, 12.1 and 12.2.

13.The Company's responses have been approved and authorised by the Board of Directors.

If you require any further information, please do not hesitate to contact us.

Merlin Diamonds Limited



9 October 2018

Mr Peter Lee

Company Secretary

By email: peterl@axisc.com.au

Dear Mr Lee

Merlin Diamonds Limited (“MED”): Financial Condition Query

ASX Limited (“ASX”) refers to the following:

- A. MED’s Full Year Statutory Accounts for the year ended 30 June 2018 lodged on the ASX Market Announcements Platform and released at 8:59 am on 8 October 2018 (the “Annual Report”).
- B. The Independent Auditor’s Report set out on pages 52 to 54 of the Annual Report which contains a qualified opinion (the “Qualified Opinion”) stating the following:

“Basis for qualified opinion

A limitation in the scope of our audit work exists for the reasons described below:

Included within Notes 10 & 27 of the financial report, the Group has reported a loan receivable from AXIS Consultants Pty Ltd amounting to \$13,752,125 (2017: \$12,158,032) which has been fully provided for. We have been unable to obtain sufficient appropriate audit evidence in respect to the collectability or otherwise of this amount.

Included within Note 11 of the financial report, the Group has reported Inventory in relation to its diamond stock at an estimated realisable value of \$637,717. We have been unable to obtain sufficient appropriate audit evidence in respect to the expected sale price of the diamond stock supporting its estimated realisable value as shown in the financial report. These uncertainties may require a further adjustment to the value of the diamond stock, should management achieve sales at materially different prices to those estimated. Furthermore, it was not feasible to observe the counting of physical inventories as at 30 June 2018 or satisfy ourselves concerning those inventory quantities of diamonds by alternative means.

Accordingly, we were unable to determine whether adjustments might have been necessary had these limitations in scope not existed.”

- C. MED’s Report on Governance lodged on the ASX Market Announcements Platform and released at 08:57 am on 8 October 2018 (“Governance Report”) which states the following:

“The Executive Director and Chief Financial Officer and Company Secretary sign off to the Board of Directors in respect to the annual financial statements and risk management policies as required by law and the ASX Corporate Governance Council “Principles of Good Corporate Governance and Best Practice Recommendations.” (“MD and CFO Declaration”).

Relevant listing rules and guidance

- Listing rule 3.1, which requires an entity, once it becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, to immediately tell ASX that information.
- Listing rule 12.2, which states that an entity's financial condition (including operating results) must, in ASX's opinion, be adequate to warrant the continued quotation of its securities and its continued listing.
- Listing rule 19.11A, which requires accounts given to ASX under the requirements of the listing rules, to be prepared to Australian accounting standards and if the entity is a foreign entity, the accounts may be prepared to other standards agreed by ASX.
- Listing rule 3.1A sets out an exception from the requirement to make immediate disclosure, provided that each of the following are satisfied.

3.1A.1 A reasonable person would not expect the information to be disclosed.

3.1A.2 The information is confidential and ASX has not formed the view that the information has ceased to be confidential.

3.1A.3 One or more of the following applies.

- *It would be a breach of a law to disclose the information.*
- *The information concerns an incomplete proposal or negotiation.*
- *The information comprises matters of supposition or is insufficiently definite to warrant disclosure.*
- *The information is generated for the internal management purposes of the entity.*
- *The information is a trade secret."*

Questions for response

In light of the information contained in the Annual Report and having regard to the above, ASX asks MED to respond separately to each of the following questions:

1. Commenting specifically on the Qualified Opinion, can MED confirm that in the Directors' opinion, the Annual Report:
 - (a) complies with the relevant Accounting Standards; and
 - (b) give a true and fair view of the financial performance and financial position of MED?
2. The Qualified Opinion states that *"Included within Notes 10 and 27 of the financial report, the Group has reported a loan receivable from AXIS Consultants Pty Ltd amounting to \$13,752,125 (2017: \$12,158,032) which has been fully provided for. We have been unable to obtain sufficient appropriate audit evidence in respect to the collectability or otherwise of this amount."*

Note 27 states that *"AXIS Consultants Pty Ltd ("AXIS"), a company of which Mr. MZ Gutnick and Dr. DS Tyrwhitt were directors during the year, provided management services to the Company for the year.*

Unsecured advances have been made to AXIS. A formal loan agreement was put in place during the year. The loan is repayable in June 2020. The interest rate on monies advanced during the year was 8.78% (2017: 8.70% to 8.80%). The nature of the consideration to be provided in settlement is through services provided or repayment in cash or shares."

With regard to the above, please respond to each of the following questions:

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- (a) Why is MED unable to provide its auditors with the formal loan agreement or any other documentation in relation to the loan receivable?
 - (b) How has MED satisfied itself of the collectability of the loan receivables balance?
 - (c) Why has the loan receivable been fully impaired?
 - (d) For what purpose(s) was the loan advanced to AXIS?
 - (e) Does MED expect the full amount of the loan to AXIS \$13,752,124 to be repaid in June 2020 as disclosed in note 27 of the Annual Report?
 - (f) What does MED receive in return for advances made to AXIS?
 - (g) Has AXIS ever repaid any amounts owing to MED previously? If so, please provide details.
 - (h) Why has the interest on this loan receivable of \$1,138,189 and other advances of \$455,903 been fully impaired?
3. The Qualified Opinion also states that *"...the Group has reported inventory in relation to its diamond stock at an estimated realisable value of \$637,717. We have been unable to obtain sufficient appropriate audit evidence in respect to the expected sale price of the diamond stock supporting its estimated realisable value as show in the financial report"*. Why is MED unable to satisfy its auditors of the value of its inventory? How has MED satisfied itself that the value of its inventory is accurate and realisable at the value at which it is recorded?
 4. What steps does MED intend to take to obtain an unqualified audit/review report for future financial periods?
 5. In relation to the Annual Report, did the Board receive the MD and CFO Declaration that in their opinion, the financial records of MED have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the Company and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively?
 6. If the answer to question 5 is 'no' why did the Board not receive the MD and CFO declaration as described in MED's Governance Report?
 7. Commenting specifically on the Qualified Opinion, does the Board consider MED has a sound system of risk management and internal control which is operating effectively?
 8. Does MED consider that its level of operations is sufficient to warrant continued quotation of its securities on ASX in accordance with the requirements of listing rule 12.1? In answering this question, please also explain the basis for this conclusion.
 9. Is MED of the view that its financial condition would be sufficient to warrant continued listing on ASX in accordance with the requirements of listing rule 12.2?
 10. If the answer to question 9 is "yes", please explain the basis on which MED has formed the conclusion that its financial condition is sufficient to warrant continued listing on ASX in accordance with the requirements of listing rule 12.2. Specifically, MED should submit the reasons (including any previous disclosures made to the market) it considers relevant given the matters outlined in the Independent Auditor's Report resulting in the Qualified Opinion.
 11. If the answer to questions 8 or 9 is "no", please explain what steps MED has taken, or proposes to take, to warrant continued listing on ASX in accordance with the requirements of listing rules 12.1 and 12.2.
 12. Please confirm that MED is in compliance with the Listing Rules and, in particular, Listing Rules 3.1, 12.1 and 12.2.

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13. Please confirm that MED's responses to the questions above have been authorised and approved in accordance with its published continuous disclosure policy or otherwise by its board or an officer of MED with delegated authority from the board to respond to ASX on disclosure matters.

When and where to send your response

This request is made under, and in accordance with, Listing Rule 18.7. Your response is required as soon as reasonably possible and, in any event, by not later than half an hour before the start of trading (ie before 9.30 a.m. AEST) on Tuesday, 16 October 2018.

ASX reserves the right to release a copy of this letter and your response on the ASX Market Announcements Platform under Listing Rule 18.7A. Accordingly, your response should be in a form suitable for release to the market.

Your response should be sent to me by e-mail. It should not be sent directly to the ASX Market Announcements Office. This is to allow me to review your response to confirm that it is in a form appropriate for release to the market, before it is published on the ASX Market Announcements Platform.

If you have any queries or concerns about any of the above, please contact me immediately.

Yours sincerely

[Sent electronically without signature]

Cheng Tang

Senior Adviser, Listings Compliance (Melbourne)