

Merlin Diamonds Limited

ACN 009 153 119

INTERIM FINANCIAL REPORT
FOR THE HALF YEAR ENDED
31 DECEMBER 2016

Merlin Diamonds Limited
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Merlin Diamonds Limited Chairman's Report

Dear Shareholder

The Company's key project is our Merlin Diamond Mine Project located in the Northern Territory of Australia.

Merlin Diamond Mine Project

Background

The Merlin diamond mine project is located some 100km south of the settlement of Borroloola in the Northern Territory and comprises 13 kimberlite pipes. Since 1998, nine of the Merlin pipes have been subject to open-pit mining over a 5 year period. These previous mining operations produced 507,000 carats of high quality diamonds. This included Australia's largest diamond at 104.73cts. In 2004, North Australian Diamonds Ltd acquired the project from the Rio Tinto parties and current management took control in 2008.

In October 2016, the Company re-commenced operations at the merlin diamond mine.'

Some highlights of the mining operations at the Merlin diamond mine since 1 October 2016 include:

Merlin Diamond Mine Operations

Successfully recommenced initial phase of operations

The processing plant was rapidly refurbished and production commenced with steady ramping up of the production process

Australia's 5th largest diamond 35.5 carats recovered

Merlin previously produced Australia's largest diamond at 104 carats. This 35.3 carat diamond reflects merlin's history of recovering large diamonds.

Discovery of rare blue diamond

The recovery of the blue diamond demonstrates the potential for valuable coloured diamonds at Merlin.

Successful mining campaign delivered circa 70,000 tonnes of ore for wet season treatment

Northern Territory based contractor successfully commenced mining in Kaye pit

\$44.6m royalty credits preserved

Through the successful commencing of operations, Merlin satisfied the requirement of the NT department of Treasury and Finance

Experienced diamond team appointed

Merlin has assembled an exceptionally experienced diamond mining executive team. This team also includes high level experienced security surrounding the finished product of rough diamonds.

Initial processing phase up-scaled with the introduction of scrubber

The commissioning of the scrubber in January 2017 significantly improves the preparation of the ore and throughput

In March 2017, the Company announced the recovery of five green diamonds from the Kaye pit, amongst them intense greens. The largest green diamond recovered is 1.4cts. In addition to this, more green diamonds

Merlin Diamonds Limited Chairman's Report

have been recovered from the ongoing mining operations at Merlin, and are being validated by independent experts. The recovery of these green diamonds is highly encouraging and follows Merlin Diamond's previous discovery of a rare blue diamond in December 2016, demonstrating the mine's potential for producing valuable coloured diamonds. The Green diamonds are extremely rare.

The Merlin diamond mine is also known for its high quality, large, super white gems. The mine has produced the largest ever diamond found in Australia at 104cts. Post recommencement of mining at the end of 2016, Merlin produced a 35.3ct diamond, continuing the mine's track record of recovering large diamonds.

During July and August 2016, project planning was undertaken to recommence operations in 2016 as soon as possible after approval of the Mining Management Plan (MMP) by the Department of Minerals and Energy (DME).

Following a detailed review of the existing 60 tph plant it was decided to simplify the plant flowsheet as well as introduce contract crushing and screening ahead of the existing DMS plant. The impact of this includes:

- Significant reduction of the capital requirement and timeline to get the operation into production
- Allowing existing oversize stockpiles to be treated for several months
- Allowing for treating +40mm ore from the open pits, which previously would have been added to the oversize stockpiles
- Reducing the risk of crushing large diamonds, which have been proven to exist at the Merlin diamond mine
- Positioning the Merlin diamond mine to scale up production of the process plant

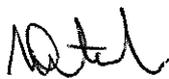
A modular final recovery unit incorporating X ray Flowsort recovery units purchased from Ellendale was transported to the Merlin diamond mine and installed and commissioned in October 2016. This together with the planned installation of a grease table for treating the Flowsort tailings is a significant improvement over the previous DMS concentrate hand-sorting methodology.

The MMP, which incorporates the environmental management plan and commitments for the project, was approved by the DME on 9 September 2016. Work immediately commenced to recommission the plant and prepare for conventional mining in the Kaye pit.

The mobile plant for the contract crushing and screening was mobilised, commissioned and began processing stockpiled material on 1 October 2016. The water from the Kaye open pit was transferred into the Gareth pit in preparation for mining of Kaye.

Following a review of the mining methodology and mine planning, initial mining in 2016/17 year will be by conventional open pit mining from Kaye and Ector. The opportunity to mine ore from the other kimberlite pipes, in particular the small but high grade Ywain and Gwain pipes, by dry clamshell mining will be evaluated over the wet season.

MZ Gutnick
Executive Chairman and Managing Director



The information in this report that relates to exploration results is based on information compiled by Dr DS Tyrwhitt who is a Fellow of the Australasian Institute of Mining and Metallurgy. Dr DS Tyrwhitt is a consulting geologist employed by DS Tyrwhitt & Associates Pty Ltd. Dr DS Tyrwhitt has 50 years' experience in the industry and has more than 5 years' experience which is relevant to the style of mineralisation being reported upon to qualify as a Competent Person as defined in the 2004 Edition of the "Australasian Code of Reporting of Exploration Results, Mineral Resources and Ore Reserves". Dr Tyrwhitt consents to the inclusion in the report of the matters based on the information in the form and context to which it appears.

Merlin Diamonds Limited
Directors' Report

The Directors present their report on Merlin Diamonds Limited (the 'Company') for the half year ended 31 December 2016.

Directors

The Directors of the Company at any time during or since the end of the interim period are:

MZ Gutnick	Executive Chairman and Managing Director
H Herzog	Non-Executive Director
D S Tyrwhitt	Non-Executive Director

Jl Gutnick – resigned 6 July 2016

Review and Results of Operations

During the six month period ending 31 December 2016, the Company progressed recommencement of the operations at the Merlin diamond mine which was the priority during the period.

The results of operations for the six months ended 31 December 2016 was a loss of \$15,692,141 (2015: \$2,053,312). Employee benefits expense for the half year was \$760,904 (2015: \$435,747) as a result of the recommencement of mining operations at Merlin; consultancy fees of \$737,384 (2015: \$852,181) primarily related to the diamond operations; lease rental expenses of \$80,676 (2015: \$115,178) reduced as a result of the reduction of office space, professional fees decreased to \$87,822 (2015: \$94,441), depreciation was \$210 (2015: \$11,088), travel costs increased to \$95,903 (2015: \$21,620), impairment of other receivable was \$2,416,099 (2015:\$nil), an increase in other expenses to \$335,958 (2015:\$273,437), a loss was incurred on the revaluation of derivative liability - convertible notes \$458,668 (2015: \$nil), fair value loss was incurred on conversion of notes of \$235,822 (2015:\$nil), exploration expensed amounted to \$707,181 (2015: \$256,362) and development expenditure incurred on previous trial mining activities was written off \$10,011,091 (2015:\$nil). Revenue for the six months ended 31 December 2016 was \$431,884 (2015: \$403,952) from interest generated on loans to other entities.

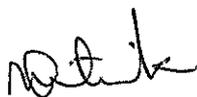
At 31 December 2016, the Company had cash and cash equivalents of \$206,870 (2015: \$1,906,830).

Auditor's Independence Declaration

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is set out on the following page.

Signed in accordance with a resolution of the Directors.

Dated at Melbourne this 16 th day of March 2017



MZ Gutnick
Chairman and Managing Director



Grant Thornton

The Rialto, Level 30
525 Collins St
Melbourne Victoria 3000

Correspondence to:
GPO Box 4736
Melbourne Victoria 3001

T +61 3 8320 2222
F +61 3 8320 2200
E info.vic@au.gt.com
W www.grantthornton.com.au

**Auditor's Independence Declaration
To The Directors of Merlin Diamonds Limited**

In accordance with the requirements of section 307C of the *Corporations Act 2001*, as lead auditor for the review of Merlin Diamonds Limited for the half-year ended 31 December 2016, I declare that, to the best of my knowledge and belief, there have been:

- a No contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review; and
- b No contraventions of any applicable code of professional conduct in relation to the review.

GRANT THORNTON AUDIT PTY LTD
Chartered Accountants

B. L. Taylor
Partner - Audit & Assurance

Melbourne, 16 March 2017

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Merlin Diamonds Limited
Statement of Profit or Loss and Other Comprehensive Income
for the half year ended 31 December 2016

		Consolidated	
	Note	31 December 2016	31 December 2015
		\$	\$
Revenue	2	431,884	403,952
Other income	3	48,679	7,055
Employee benefits expense		(760,904)	(435,747)
Consultancy fees		(737,384)	(852,181)
Insurance expenses		(50,425)	(25,197)
Lease rental expenses		(80,676)	(115,178)
Professional fees		(87,822)	(94,441)
Travel expenses		(95,903)	(21,620)
Depreciation expenses		(210)	(11,088)
Exploration expensed		(707,181)	(256,362)
Development expenditure written off	5	(10,011,091)	-
Impairment of other receivable		(2,416,099)	-
Loss on disposal of trading securities		-	(370,800)
Loss on conversion - notes		(235,822)	-
Fair value loss on derivative liability – convertible note	7	(458,668)	-
Other expenses		(335,958)	(273,437)
Finance expense	4	(194,561)	(8,268)
Loss from continuing operations		(15,692,141)	(2,053,312)
Income tax expense		-	-
Loss for the period		(15,692,141)	(2,053,312)
Other comprehensive income for the period, net of income tax			
Items that may be reclassified subsequently to profit or loss:			
Exchange differences on translation of foreign operations		62,768	(1,856)
Total comprehensive loss for the period		(15,629,373)	(2,055,168)
Loss attributable to members of Merlin Diamonds Limited		(15,692,141)	(2,053,312)
Total comprehensive loss attributable to members of Merlin Diamonds Limited		(15,629,373)	(2,055,168)
Basic loss per share (cents per share)		(2.84)	(0.47)
Diluted loss per share (cents per share)		(2.84)	(0.47)

The accompanying notes form part of these half year financial statements.

Merlin Diamonds Limited
Statement of Financial Position
as at 31 December 2016

	Note	Consolidated	
		31 December 2016 \$	30 June 2016 \$
Assets			
Current assets			
Cash and cash equivalents		206,870	1,906,830
Trade and other receivables		620,748	148,885
Inventories		431,217	6,020
Total current assets		1,258,835	2,061,735
Non-current assets			
Other receivables		789,771	789,771
Plant and equipment		1,476,634	1,533,378
Development expenditure	5	4,049,918	10,011,091
Total non-current assets		6,316,323	12,334,240
Total assets		7,575,158	14,395,974
Liabilities			
Current liabilities			
Trade and other payables		4,622,145	3,541,821
Derivative liability at fair value	7	1,748,904	91,000
Provisions		76,204	53,315
Total current liabilities		6,447,253	3,686,136
Non-current liabilities			
Borrowings	8	1,342,672	2,397,537
Convertible notes	6	1,172,695	274,866
Provisions		1,591,564	1,229,396
Total non-current liabilities		4,106,931	3,901,799
Total liabilities		10,554,184	7,587,935
Net (liabilities)/assets		(2,979,026)	6,808,040
Equity			
Issued capital	9	149,661,031	143,818,724
Reserves		622,160	622,160
Accumulated losses		(153,262,217)	(137,632,844)
Total (deficiency)/equity		(2,979,026)	6,808,040

The accompanying notes form part of these half year financial statements.

Merlin Diamonds Limited
Statement of Changes in Equity
for the half year ended 31 December 2016

Consolidated	Issued capital \$	Options reserve \$	Equity settled incentive options reserve \$	Accumulated losses \$	Total equity \$
Balance at 1 July 2015	142,991,154	-	763,560	(133,416,262)	10,338,452
Loss for the period	-	-	-	(2,053,312)	(2,053,312)
Other comprehensive loss for the period, net of tax	-	-	-	(1,856)	(1,856)
Total comprehensive loss for the period, net of tax	-	-	-	(2,055,168)	(2,055,168)
Transactions with owners, recorded directly in equity					
Issue of options	-	52,949	-	-	52,949
Employee incentive option scheme	-	-	-	-	-
Issue of shares	600,000	-	-	-	600,000
Transaction costs arising on share issues	(5,313)	-	-	-	(5,313)
Total transactions with owners	594,687	52,949	-	-	647,636
Balance at 31 December 2015	143,585,841	52,949	763,560	(135,471,430)	8,930,920
Balance at 1 July 2016	143,818,724	-	622,160	(137,632,844)	6,808,040
Loss for the period	-	-	-	(15,692,141)	(15,692,141)
Other comprehensive loss for the period, net of tax	-	-	-	62,768	62,768
Total comprehensive loss for the period, net of tax	-	-	-	(15,629,373)	(15,629,373)
Transactions with owners, recorded directly in equity					
Issue of options					
Employee incentive option scheme	-	-	-	-	-
Issue of shares	5,963,648	-	-	-	5,963,648
Transaction costs arising on share issues	(121,341)	-	-	-	(121,341)
Total transactions with owners	5,842,307	-	-	-	5,842,307
Balance at 31 December 2016	149,661,031	-	622,160	(153,262,217)	(2,979,026)

The accompanying notes form part of these half year financial statements.

Merlin Diamonds Limited
Statement of Cash Flows
for the half year ended 31 December 2016

	31 December 2016	31 December 2015
	\$	\$
Cash flows from operating activities		
Receipts from customers (inclusive of GST)		-
Payments to suppliers and employees (inclusive of GST)	(1,673,191)	(561,309)
Payments for exploration expenditure	(241,954)	(77,168)
Interest received	416	111
Net cash used in operating activities	(1,914,729)	(638,366)
Cash flows from investing activities		
Receipt for disposal of trading securities	-	283,554
Payments for acquisition of plant and equipment	(174,799)	-
Payments for development expenditure	(2,830,369)	(706,635)
Payment of security deposits	(313,909)	-
Payment to other entity	(2,604,404)	(152,722)
Repayment by other entity	620,000	54,026
Net cash used in investing activities	(5,303,481)	(521,777)
Cash flows from financing activities		
Borrowings from others	8 745,236	-
Loan from other entities	-	54,927
Proceeds from issue of equity securities	3,572,728	600,000
Proceeds from issue of convertible note	1,325,866	500,000
Repayment of loan to other entity	(59,154)	-
Repayment of loan to Director	-	(90,500)
Equity securities issue transaction costs	(66,426)	(5,313)
Net cash provided by financing activities	5,518,250	1,059,114
Net decrease in cash and cash equivalents	(1,699,960)	(101,029)
Cash and cash equivalents at 1 July	1,906,830	115,940
Cash and cash equivalents at 31 December	206,870	14,911

The accompanying notes form part of these half year financial statements.

Merlin Diamonds Limited
Notes to and forming part of the Financial Statements
for the half year ended 31 December 2016

1. Basis of preparation

Merlin Diamonds Limited (the 'Company'), is a company domiciled in Australia. The consolidated interim financial statements of the Company as at and for the half year ended 31 December 2016 comprise the Company and its subsidiaries (together referred to as the 'Group'). These interim financial statements were approved by the directors on 16 March 2017.

The half year financial report is a general purpose financial report prepared in accordance with the Corporations Act 2001 and Australian Accounting Standards (AASBs) including AASB 134 Interim Financial Reporting. Compliance with AASB 134 ensures compliance with International Financial Reporting Standard IAS 34 'Interim Financial Reporting'.

Except as described below, these interim financial statements have been prepared by a for profit entity on the basis of accounting policies and methods of computation consistent with those applied in the 30 June 2016 annual financial statements contained within the Annual Report of the Group.

The half year financial report does not include notes of the type normally included in the annual financial report and shall be read in conjunction with the annual report for the year ended 30 June 2016 and any public announcements made during the interim reporting period in accordance with the continuous disclosure requirements of the ASX Listing Rules.

Going Concern

The Company has incurred a loss of \$15,629,373 in the half-year to 31 December 2016, had net cash operating outflow of \$1,914,729 for the half-year ended 31 December 2016 and has negative working capital of \$5,188,418 at 31 December 2016. In late 2016, the Company commenced mining operations at the Merlin diamond mine and since that time has ramped up production. In order to continue as a going concern, the success of the mining operations at the Merlin diamond mine will be important to the cashflow of the Company. In addition the Company will be required to raise further capital or obtain loan funding to meet its commitments. These conditions indicate a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern. In considering whether the Company is a going concern, the Directors note that a fully underwritten entitlements issue totalling \$5,535,000 closes on 20 March 2017. The Directors are confident of raising additional capital if required. The Directors believe the going concern basis to be appropriate for the reasons referred to previously. Based on the forecast cashflows of the Company, the Directors are satisfied that adequate plans are in place and that the Company will be able to raise sufficient cash for a minimum of 12 months from the date of signature of the financial report. Should the Company be unable to continue as a going concern, it may be required to realise its assets and extinguish its liabilities other than in the ordinary course of business, and at amounts that differ from those stated in the financial statements. These financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts or classification of liabilities and appropriate disclosures that may be necessary should the Company be unable to continue as a going concern.

Historical cost convention:

The half-year financial report is prepared in accordance with historical cost, except for some categories of investments and some financial instruments which are recorded at fair value. Cost is the fair value of the consideration given in exchange for net assets acquired.

Critical accounting judgements and key sources of estimation uncertainty:

Management is required to make judgements, estimates, and assumptions about carrying values of assets and liabilities that are not readily apparent from other sources.

The Group makes certain estimates and assumptions concerning the future. Estimates and assumptions have been utilised for the impairment testing of exploration assets. Actual results may

Merlin Diamonds Limited
Notes to and forming part of the Financial Statements
for the half year ended 31 December 2016

differ from estimates. By their nature, these estimates incorporate inherent risks as they are based on future events which could have a material impact on the value of assets and liabilities in this financial year.

(a) Change in accounting policy

New, revised or amending Accounting Standards and Interpretations adopted

The Group has adopted all of the new, revised or amending Accounting Standards and Interpretations issued by the Australian Accounting Standards Board ('AASB') that are mandatory for the current reporting period, however, the Group did not have to change its accounting policies or make retrospective adjustments as a result of adopting these standards. There may be some changes to the disclosures in the 30 June 2017 annual report as a consequence of these amendments.

Impact of standards issued but not yet applied by the entity

Any new, revised or amending Accounting Standards or Interpretations that are not yet mandatory have not been early adopted. The Group has reviewed the impact of these Standards and Interpretations and are continuing to assess where they will have a significant effect on the financial position or performance of the Group.

The Group has not elected to early adopt any new standards or amendments

2. Revenue

	Consolidated	
	31 December 2016	31 December 2015
	\$	\$
Interest income	189	256
Interest income – other entity	431,695	403,696
Total revenue	431,884	403,952

3. Other income

	Consolidated	
	31 December 2016	31 December 2015
	\$	\$
Fuel tax credits	48,679	7,055

4. Finance expense

	Consolidated	
	31 December 2016	31 December 2014
	\$	\$
Bank charges	(192)	(647)
Borrowing costs	(194,369)	(7,621)
Total finance expense	(194,561)	(8,268)

Merlin Diamonds Limited
Notes to and forming part of the Financial Statements
for the half year ended 31 December 2016

5. **Development expenditure**

	Consolidated	
	31 December 2016	30 June 2016
	\$	\$
Balance at beginning of period	10,011,091	8,436,680
Expenditure incurred during the period	4,049,918	840,795
Amount written off	(10,011,091)	-
Carrying amount at end of period	4,049,918	10,011,091

6. **Convertible notes**

	Consolidated	
	31 December 2016	30 June 2016
	\$	\$
Non-current		
Convertible notes	1,172,695	274,866
	1,172,695	274,866

Convertible Notes

The Consolidated Entity has issued 10% convertible notes, with a face value of \$1.00 each with an expiration date of 36 months from the date of issue. Interest is required to be paid half yearly in arrears at a rate of 10% per annum based on the face value. The accrued interest at 31 December 2016 is \$118,935. The notes are convertible into fully paid ordinary shares of the parent entity at conversion price of 1.3 cents. The Company may by written notice prior to the maturity date but not until after the expiry of the initial period of 12 months, redeem the principal outstanding plus any accrued interest. The convertible notes are secured. The convertible notes have been valued by an independent third party based on the estimated conversion date, conversion price, expected dividends, expected volatility and the estimated risk free interest rate.

7. **Derivative Liability at fair value**

	Note	Consolidated	
		31 December 2016	30 June 2016
		\$	\$
Non-current			
Carrying amount at 1 July		91,000	-
Recognition of derivative from convertible notes		3,352,387	253,000
Fair value movement		458,668	(162,000)
Convertible notes converted to shares		(2,153,151)	-
		1,748,904	91,000

Merlin Diamonds Limited
Notes to and forming part of the Financial Statements
for the half year ended 31 December 2016

Due to the terms of the convertible notes there is an embedded derivative liability. The derivative liability is measured at fair value on date of issue and remeasured at fair value at subsequent reporting periods, with a gain/loss in the statement of profit or loss and other comprehensive income. The value of the derivative fluctuates with the Company's underlying share price and the time to expiry. The change in the value of the derivatives between inception and 31 December 2016 is due to the difference in the share price between inception and 31 December 2016.

The derivative liability is measured at fair market value and is a Level 2. The fair value of the Level 2 embedded derivative has been estimated using the forward pricing model. The options were valued using an amended Binomial methodology.

A fair value loss was recorded of \$458,668 based on a valuation of the notes. The carrying value of the convertible notes at 31 December 2016 approximates their fair value at that date.

8. Borrowings

	Note	Consolidated	
		31 December 2016	30 June 2016
		\$	\$
Non-current			
Loans - other		1,342,672	2,397,537
		<u>1,342,672</u>	<u>2,397,537</u>

Loans - other

The loans - other are secured notes, interest is to be charged at the rate of 10%, payable on repayment of the notes and there are no fixed terms for repayment of the notes between parties.

Interest is paid half yearly in arrears at a rate of 10% per annum based on the face value. The notes require shareholder approval to be re-classified as convertible notes, and if shareholder approval is obtained, are convertible into fully paid ordinary shares of the parent entity at conversion price of 1.3 cents. The Company may by written notice prior to the maturity date but not until after the expiry of the initial period of 12 months, redeem the principal outstanding plus any accrued interest. The notes are secured. The accrued interest at 31 December 2016 is \$49,899.

9. Capital and reserves

Ordinary share capital

	31 December	30 June 2016	31 December	30 June 2016
	2016		2016	
	No. Shares	No. Shares	\$	\$
Balance at beginning of period	451,257,719	431,334,750	143,818,724	142,991,154
Share Placement 13 July 2015 @ 6.5 cents per share	-	1,538,461	-	100,000
Share Placement 24 September 2015 @ 6.5 cents per share	-	7,692,304	-	500,000
Consulting and promotional fees 11 May 2016 @ 2.2 cents per share	-	10,692,204	-	235,228
Share placement 31 August 2016 @ 1.5 cents per share	50,000,000	-	1,000,000	-

Merlin Diamonds Limited
Notes to and forming part of the Financial Statements
for the half year ended 31 December 2016

	31 December 2016 No. Shares	30 June 2016 No. Shares	31 December 2016 \$	30 June 2016 \$
Consulting fees 31 August 2016 @ 1.5 cents per share	2,000,000	-	30,000	-
Consulting fees 31 August 2016 @ 2.0 cents per share	4,317,090	-	87,084	-
Conversion of convertible note 2 September 2016 @ 1.9 cents per share	26,136,933	-	496,602	-
Consulting and promotional fees 2 September 2016 @ 1.5 cents per share	12,100,000	-	181,500	-
Consulting and promotional fees 20 October 2016 @ 2.2 cents per share	4,166,667	-	91,667	-
Conversion of convertible notes 8 November 2016 @ 1.9 cents per share	6,666,666	-	126,667	-
Conversion of convertible notes 17 November 2016 @ 1.8 cents per share	50,608,935	-	910,961	-
Conversion of convertible notes 18 November 2016 @ 1.8 cents per share	32,666,667	-	588,000	-
Conversion of convertible notes 22 November 2016 @ 1.8 cents per share	11,760,274	-	210,000	-
Conversion of convertible notes 29 November 2016 @ 1.8 cents per share	3,333,333	-	60,000	-
Share placement 15 December 2016 @ 1.3 cents per share	102,423,076	-	1,331,500	-
Conversion of convertible notes 21 December 2016 @ 1.6 cents per share	6,666,666	-	106,667	-
Consulting and promotional fees 21 December 2016 @ 1.3 cents per share	24,000,000	-	312,000	-
Share placement 21 December 2016 @ 1.3 cents per share	15,384,615	-	200,000	-
Consulting and promotional fees 21 December 2016 @ 1.6 cents per share	1,562,500	-	25,000	-
Consulting and promotional fees 21 December 2016 @ 1.8 cents per share	2,000,000	-	36,000	-
Consulting and promotional fees 21 December 2016 @ 1.9 cents per share	10,000,000	-	170,000	-
Transaction costs arising on share issues	-	-	(121,341)	(7,658)

Merlin Diamonds Limited
Notes to and forming part of the Financial Statements
for the half year ended 31 December 2016

	31 December 2016 No. Shares	30 June 2016 No. Shares	31 December 2016 \$	30 June 2016 \$
Balance at end of period	817,051,141	451,257,719	149,661,031	143,818,724

10. Employee Share Options

a. Movement in share options on issue and period expense

	For the half year ended December 31, 2016	
	Number of options	Weighted average exercise price \$
Balance at beginning of period	23,200,000	0.15
Granted during the period	-	-
Expired during the period	-	-
Forfeited during the period	200,000	-
Balance at end of period	23,000,000	0.15
Exercisable at end of period	15,333,333	

During the half year period ended 31 December 2016 the Company recognised a net expense of \$nil (2015: \$nil) within the profit and loss component of the statement of comprehensive income.

b. Options outstanding at the end of the half year ended December 31, 2016

The share options outstanding at December 31, 2016 had a weighted average exercise price of \$0.15 and a weighted average remaining contractual life of 2.91 years.

c. Options issued during the period

During the half year ended 31 December 2016 no options were issued by the Company. It is a requirement that the employee receiving the options be still be employed by the Company at the end of each vesting period in order to exercise the options.

d. Options forfeited during the period

During the half year ended 31 December 2016, 200,000 options (2015: nil) were forfeited by employees.

11. Segment reporting

The principal business of the group is the exploration and development of diamond projects in Australia.

Management has determined the operating segment based upon reports reviewed by the Board and executive management that are used to make strategic decisions. Management and the Board consider the business only from a diamond exploration and development perspective and therefore only review reports based upon its current diamond exploration and development operations as disclosed within these financial statements. Whilst the Company has invested limited capital into its overseas operations, both the Board and management consider these currently insignificant for

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separate segment reporting purposes. There are no sales or material non-current assets other than those listed in Australia.

12. Contingent liabilities

There is no material change to contingent liabilities that the Company has become aware of since 30 June 2016.

13. Subsequent events

Other than the matters outlined elsewhere in these financial statements, no matters or circumstance have arisen since 31 December 2016 that have a significant effect on the Company.

In February 2017, the Company lodged with ASIC and ASX a prospectus for an Entitlements Offer to raise \$5,535,000 before costs.

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In the opinion of the Directors of Merlin Diamonds Limited (the 'Company'):

1. the financial statements and notes, set out on pages 6 to 16 are in accordance with the Corporations Act 2001, including:
 - (a) giving a true and fair view of the consolidated entity's financial position as at 31 December 2016 and of its performance, for the half year ended on that date; and
 - (b) complying with the Australian Accounting Standard AASB 134 'Interim Financial Reporting' and the Corporations Regulations 2001 and other mandatory professional reporting requirements;
2. there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Signed in accordance with a resolution of the Directors.

Dated at Melbourne this 16th day of March 2017.



MZ Gutnick
Chairman and Managing Director

The Rialto, Level 30
525 Collins St
Melbourne Victoria 3000

Correspondence to:
GPO Box 4736
Melbourne Victoria 3001

T +61 3 8320 2222
F +61 3 8320 2200
E info.vic@au.gt.com
W www.grantthornton.com.au

Independent Auditor's Review Report To The Members of Merlin Diamonds Limited

We have reviewed the accompanying half-year financial report of Merlin Diamonds Limited (the Company), which comprises the consolidated financial statements being the statement of financial position as at 31 December 2016, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the half-year ended on that date, notes comprising a statement or description of accounting policies, other explanatory information and the directors' declaration of the consolidated entity, comprising both the Company and the entities it controlled at the half-year's end or from time to time during the half-year.

Directors' Responsibility for the Half-year Financial Report

The Directors of Merlin Diamonds Limited are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such controls as the Directors determine is necessary to enable the preparation of the half-year financial report that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express a conclusion on the consolidated half-year financial report based on our review. We conducted our review in accordance with the Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the half-year financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the consolidated entity's financial position as at 31 December 2016 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Merlin Diamonds Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

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A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Independence

In conducting our review, we complied with the independence requirements of the *Corporations Act 2001*.

Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Merlin Diamonds Limited is not in accordance with the *Corporations Act 2001*, including:

- a giving a true and fair view of the consolidated entity's financial position as at 31 December 2016 and of its performance for the half-year ended on that date; and
- b complying with Accounting Standard AASB 134 *Interim Financial Reporting* and *Corporations Regulations 2001*.

Material Uncertainty related to Going Concern

We draw attention to Note 1 to the interim financial report which notes net operating cash outflows of \$1,914,729 and a negative working capital position of \$5,188,418 for the period ended 31 December 2016. These conditions, along with other matters set forth in Note 1, indicate the existence of a material uncertainty which may cast significant doubt about the company's ability to continue as a going concern and therefore, the company may be unable to realise its assets and discharge its liabilities in the normal course of business, and at the amounts stated in the financial report. Our report is not modified in relation to this matter.



GRANT THORNTON AUDIT PTY LTD
Chartered Accountants



B. L. Taylor
Partner - Audit & Assurance

Melbourne, 16 March 2017