Bonas

Diamond Brokers & Consultants

Market Report

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Rough

There is genuine respect for the way in which **DTC** has handled pricing and distribution issues in the last few months. Many were amazed at the continuing heat after what they considered an inevitable January increase. However most people are concerned above all with the creation of a sustained and gradual recovery, and are therefore supportive of a measured pricing policy as displayed by DTC, as opposed to the behaviour of some other producers. Obviously self interest plays a part in this, but at least as important is the nagging feeling that another possible correction in rough never feels that far away.

Antwerp

The DTC price adjustment this month was no surprise. Before the January sight, **BHP** concluded its spot market sale with prices on average 9% higher than in December, and a total volume sold of $32m plus a similar amount in term contracts. This month about 40% of the term contract goods were refused. On February 26th all term contracts (worth 60% of production) will be re-auctioned for the period until September.

BHP goods are considered very expensive and therefore not very desirable on the secondary market.

Meanwhile at the DTC, everyone agreed the price adjustment was done intelligently, in the right areas and was well balanced. What is more, looking at it from a manufacturing point, the goods are manageable in value.

A shame then, to see that the secondary market went off the scale; most premiums paid are between 10-15%. From the point of view of the seller, there is obviously the temptation to make a quick profit rather than waiting for money back in 6 months, but equally the seller also knows that he will not be able to replace that box. Acceptance of the latter indicates that people either expect polished demand to be sluggish, or that they can source polished from the market as and when needed.

The Russian goods that came onto the market this month are mainly deliveries from December. This month, **Alrosa** has decided to limit sales to contracts only. It seems they are also negotiating a handful of new contracts - contracts that, by the way, have become gradually more attractive. Goods outside of the contracts have become more expensive by a high single digit figure.

With rough prices on the increase, one would expect more miners to resume operations. This year everyone is looking at **Angola**, a producer that in 2009 was conspicuous only by its absence.

We believe the market is very volatile and that it is important to continue monitoring and adjusting rough prices in relation to polished demand and pricing, rather than chasing the last dollar, as some others are doing, and risking setting off a rough slump.

Mumbai

The new year on the Indian market opened on a very upbeat note. With global polished sales improving marginally, pricing in some bands of polished (pique goods in stars) back to the peak prices of 2008, and polished inventories very low, most companies were cash rich and low on stock. The appetite for rough therefore continued to expand this month.

In fact the market was so voracious for rough that a lot of boxes were pre-sold before the sight even opened. These buyers felt that there would be a shortage in the market and were willing to pay premiums blindly. The prices in some of the boxes like ABC, Grey Rejections and Preparers 3-6 grs were queried as the assortments had deteriorated by 4%. Overall assortments in BHP were also found weak and boxes like +7-3gr MB White, +7-3gr Cliv White, +7 Rejns are being sold at -3% on List. In the second week after the sight, the same boxes that sold in double digit premiums during and pre-sight were being sold at a loss.

On the manufacturing front, Ahmedabad is facing a severe worker shortage, due to low pay scales and high living costs. There is brisk activity in -2 and +2 polished and the manufacturing is more into rough like Australian 7/5, Grey Rejections, BHP Browns -11+5 and Russian 7/5 which caters for this type of polished.

The situation in Bhavnagar is a little better than Ahmedabad. At the moment this centre is producing rose cuts, single cuts and velendi/polki (rough piece given shape for jewellery). Major production lies in Argyle Rolls 3 packets ($6) and 6 packets ($12.50), MB 7/5 Catoca, MB 7/5 Brown, MB 5/3, MB 3/2, ABC, BHP -11+5 and Diavik Browns -11+5.

Tel Aviv

Everyone has been taken aback by the levels to which rough has risen, over and above the DTC increase. The Indians are pushing prices up and the rest of the world has little to say in the matter.

Despite the near doubling of the sight volume, which led to an increase in second hand box trading, Israeli box trading has not significantly increased for two reasons:

Manufacturers need the goods for the polished – there is no cheaper supplier for rough at the moment. Buying polished in India is not really an option – in fact the tide is running the other way for now.
Even the most optimistic non-sightholders do not see any of the boxes coming out after paying the premiums.

Everyone talks of a likely price correction downwards in March/April when today's expensive rough comes out as polished. The tightly spaced sights could have a calming influence on premiums. This does not however cancel out the risk of buying at today's prices.

New York

The New York market firmly believes that the policy of the producers curtailing rough production over the last 12 months or so has most certainly been the right one.

Although rough trading in New York is extremely limited today, the talk is very much of DTC goods being of good value compared to other mining houses, despite the alteration in price. People cannot see a way of making any money on large RTZ & BHP goods today. That said concern remains of the market slumping around March/April.

Polished

Antwerp: Most people in Antwerp believe real recovery will be long and slow. Demand for polished has increased. Polished traders can't make the prices they estimate they need on the basis of current rough, but they often end up giving in not to lose the customer (how to replace?). Buyers are prepared to pay the new price only if they really need (and can't easily find) the goods, usually because they have confirmed orders, and want to fill a gap.

Good movement has been reported in (dossier) pointers (VS, SI/ G+), goods in D, H colour and shortages in Triple Exc. 1ct up and SI3 quality down across the board. The struggle over prices continues. In addition to this, one has to give credit to sell. It is hard to gauge the overall level of polished stocks in Antwerp; some say it is at an 'all time low', others report there are still plenty of goods around, except for a few holes.

Tel-Aviv: Polished prices in India are higher than polished here and as a result we see Indians 'hoovering up' polished here. Israelis are happy to sell as they see a profit but it is far from clear how they will replenish these goods. Prices in NY are said to be even lower though it is difficult to find big businesses of polished there.

Demand from Hong Kong/China has slowed a bit but is still there. As is typical of buyers there, they are resisting price increases vigorously. There are also reports of Chinese companies delaying payments more than usual, citing the Shenzhen incident as an excuse.

Polished prices are slightly up across the board for popular products and stable for everything else. Some improvement in +3ct, most noticeably in square edge fancies. Rapaport recently raised his price list in this size range.

Mumbai: The trade as a whole continues to be very positive, despite setbacks like the arrest of Indians in Shenzen. Diamantaires have trimmed down their inventory levels, and are comfortable with the polished they hold. While it is difficult to fetch better prices, some areas like cheaper melee and pointers where there is a shortage are seeing a rise. Profitability remains a problem for the secondary manufacturers. The expected price hike is not viewed positively by the market in the -11 area of rough as polished prices are not appreciating in this area.

Caraters in VS+ and I1- are very much in demand with some sellers out of stock and some holding back goods. 0.50-0.99 is also in good demand.

New York: Though business is far from booming, it is far stronger than was imagined even a month ago. The better than anticipated retail sales during the season have led to a healthy level of reordering. There are considerable shortages is some areas of polished, particularly triple excellent, clean goods between 1 and 3 carats, and also in some 5 carat ranges. When these goods do appear they are being purchased immediately at very strong prices. Here at least, prices have almost hit pre-recession levels.

Large special stones still remain someway behind the curve, but even here, there has been a moderate improvement. Caraters VVS-VS, D-G colours, triple-EX are very popular with scant availability.

Hong Kong: Polished trading levels in the local market were down on average between 15-40% in 2009. Those trading more with jewellery manufacturers were affected more than others. For 2010, traders are more optimistic and expect business to grow again.

Just across the border in Shenzhen, the market has been shaken up by raids and arrests as a result of diamond smuggling. More arrests two Fridays ago, this time of Chinese individuals, has shaken up people even more. Consequently, some of the many Chinese – flocking to Antwerp every month now – were trying to cancel businesses again. It seems the events have brought business in and around Shenzhen to a standstill, and this will likely remain so for a while. In all likelihood, and as a consequence, more business will shift to Shanghai, where people can import the goods to China through the Shanghai Diamond Exchange and pay 4% VAT.

The next HKG Jewellery Show starts on the 5th of March. This is shortly after CNY and it will be interesting to see how re-ordering from the retailers will be.

1 ct, D/E colour still in demand but with price resistance. Some shortages in the 0.80-0.85 ct range.

Retail

EUROPE

Except for a few niches, diamond jewellery sales in Europe remain rather slow. It is clear that we are quite a long way off good health and some people even think the market is still shrinking. Mass marketers struggle most, while independents perform relatively well thanks to the strength of their local brand name and loyal customer base. Jewellery buyers remain very cautious when placing their orders, hence volumes are small and focused on designs they know they can sell. This behaviour shows that many European retailers didn't have a great season and lack confidence to stock up. It remains difficult to collect receivables in Europe.

Feedback from the Vicenza show ranges from good to nothing exciting. It was more of a disappointment for loose diamantaires than jewellery manufacturers. The show was shortened by 3 days which was received well as some exhibitors tried to keep overheads as low as possible. Buyers placed rather conservative orders and squeezed suppliers on price (especially in the lower end).The struggle of many local Italian manufacturers continues and it is expected that quite a number will go out of business.

Positive feedback was received from the independent Geneva watch show (Le Salon International de La Haute Horlogerie) in January, mainly driven by Chinese visitors and orders.

The Swiss Watch Federation forecasts a 7% increase in exports in 2010.

USA

The National Retail Foundation (NRF) released an early estimate of 2009 holiday sales indicating a 1.1% rise to $446.8bn. Overall retail sector sales were up 2.3% in December, making up for a disappointing 0.5% year on year fall in November. Looking ahead to 2010, the NRF estimate retail sales will be up 2.5% on 2009, this would take the US back to approximately 2008 levels.

US/UK giant, **Sterling**, reported a 5.6% rise in the nine weeks to Jan 2nd 2010. Strongest growth was in the US which saw a 7.6% rise. CEO, Terry Burman, highlighted growth in differentiated product sales. In the UK same store sales for the period were down 0.8%, though diamonds were highlighted as an area of strength.

Zales reported a 12% drop in same store sales for the months of November and December with revenue falling 15.1% to $494m, down from $582 in the same period 2008. Although December's 9.2% sales decrease was less disappointing then November's 18.6% fall both figures were below the industry average. A few days after the release of their interim results Zales announced the departure of CEO Neal Goldberg, Chief Stores Officer William Acevedo and Chief Merchandising Officer Mary Kwan. Zales President, Theo Killion, will temporarily stand in as CEO and EVP Supply Chain, Gil Hollander will take on the CMO role.

Tiffany reported strong holiday sales up 17.9% year on year to $779.1m. US sales rose 13%; 16% up in November and 10% up in December. Same store sales in the US were up 10% and the flagship New York City store saw a 20% increase in revenue. US catalogue and internet sales were up 17% on the previous year.

Birks & Mayors holiday results were up 6% on the previous year's figures at $69.7m. Same store sales were up 6% in Canada and down 6% in the US for the period but the company gained from changes in reporting methodology.

Saks Inc reported sales up 11.1% for the five weeks ended January 2, up from $354.4m in the comparable period 2008/09 to $393.6m. Fine jewellery sales, however, were singled out as an under-performing area.

BJ's Wholesale Club also reported jewellery as one of its weakest sales areas, although Neiman Marcus indicated fine jewellery as a star performer for the season.

HONG KONG AND CHINA

Business in China was strong in the last quarter of 2009, and continued strongly in the first month of this year. Everyone is now looking to CNY in only 10 days from now. Most retailers are optimistic and think they will have good sales, mainly in the 0.15-0.30ct bracket.

According to the Boston Consultancy Group, China will become the world's biggest luxury market by the middle of this decade as consumers see incomes grow along with sustained appetite for high-end brands. The BCG estimates that high-net-worth-individual households will grow from 417,000 to 609,000 by next year as luxury brand competition moves to China's developing inland cities.

Quite apart from this country data, nationality data is even more impressive: e.g. Chinese spending now accounts for 15% of luxury goods revenues recorded in France and the Chinese consumer will, on an onshore plus offshore basis, become the number one clientele for the sector maybe as early as next year.

INDIA

High gold prices have resulted in the sale of diamond jewellery picking up, especially in the South. With the stock market and real estate picking up, and the rupee holding strong, retail sales in India have received a further push. Most jewellery manufacturers have seen a healthy increase in their profits as a result of increased sales.

The high price of gold, however, is a cause for concern in the country along with sharply rising inflation, which could deter people from buying jewellery.