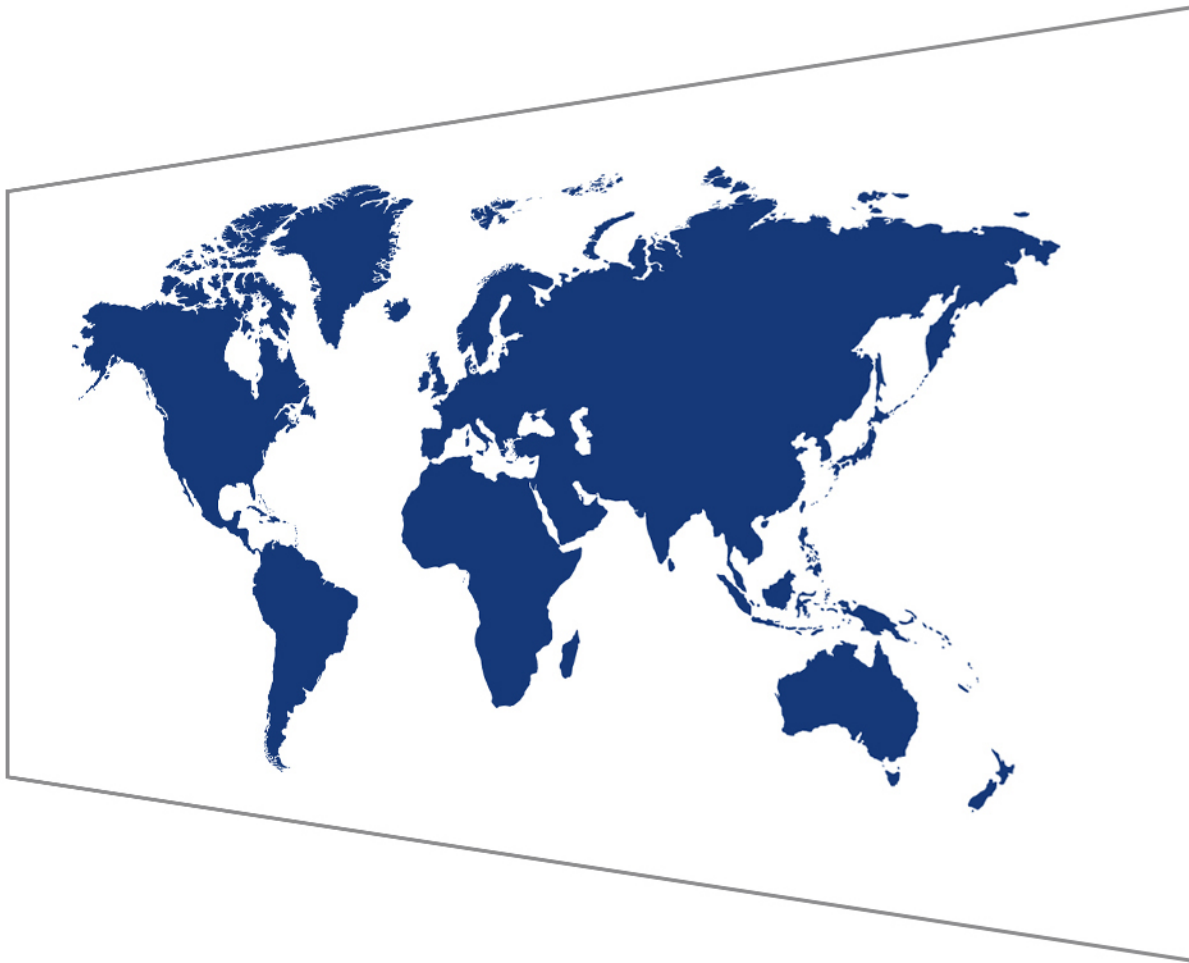


Market Report

April 2011





Rough

GENERAL COMMENT

There was a sharp intake of breath at the DTC sight as people began to grasp the scale of the most recent price increase, but diamantaires are nothing if not adaptable.... Pretty quickly healthy premiums were again being quoted on the rough.

An excellent Hong Kong show has been followed by a good Basel, and polished demand is good to very strong from virtually all world markets. Stars remain red hot, melees are very firm, some questions about the pointer area and 4grs continues to also be very strong.

Reality checkpoint should come in May, when the presumed combination of the traditionally quiet season in polished, and the arrival of much dearer production coming out of the pipeline, will tell us how strong this market actually is. A lot will depend on how much has really been manufactured, and how much rough has been stashed away.

Most people were fairly pleased with their new ITOs [DTC's Intention to Offer sightholders volume of rough for the coming 10 sights], though the drastic cut in caratage over the last year is a worrying issue, particularly for those with beneficiation in mind.

ANTWERP

In a way we could take last month's market report and reinforce it by a multiple. There is still little sign of "cooling" in the rough market.

Indeed, since the DTC increased prices in February, others have followed suit and tender results continue to beat records. The DTC March price increase didn't come as a surprise, but people thought it would be more targeted on specific areas of boxes and not as widely spread. The increase was significant – more than expected – but in medium and large, certain boxes appeared to have nicer assortments.

And again, just as last month, the market's response was firm: second hand boxes were traded at premiums no lower than one month ago. The ITOs, which to a large extent will determine supplies from the DTC for the next year, were not surprisingly up in value, given the price increases over the last 12 months, however certain areas in smalls and cheap goods are down dramatically in carats.

As was expected, a price of Russian rough has reportedly increased significantly. Clearly, on the contract goods, there was some catching up to do in order to match the new market reality. For about three days, the secondary market in Russian goods showed signs of a weakening, but that didn't last, and goods trade quickly and premiums are strong again.

Sales at BHP were said to be down to about \$120m and in carats it was down a good 15%. Typically for these goods, traders seem to hold on to them and sell the next month but at new prices.

Strong prices for rough, which started from the bottom end and in the small goods (Rio Tinto last month apparently significantly increased the prices of its Argyle production), has gradually worked their way up to medium and large sizes.

One of the things supporting polished prices is the fact that some rough actually doesn't make it to the polishing wheel, but gets traded several times over. Certain areas of polished therefore show shortages.

MUMBAI

There are some signs of the market's traditional slow down for summer holidays in India, both in rough and polished. This comes on the back of DTC's price increase, which took time to be digested by the Indian market and with trading resuming only from the second day of sight week. However, not many boxes are believed to have changed hands as premiums being quoted were quite high. India's fantastic performance at the cricket World Cup added to slow trading. There is word that if rough continues to be strong then many small units will go for early closures for summer vacation.

Surat

There is an increase in the pace of manufacturing since January, when manufacturing momentum was kept low-key due to lack of workers and with some possibly encouraging a shortage in smaller goods to push polished prices up. On average, most of the factories are currently operating at 60% capacity, however the new output still falls short of demand.

Liquidity is an issue amongst small players who have had to buy expensive rough and now need to settle end-of-year payments. This small group of manufacturers, even in this bull-run, have had to resort to selling polished parcels to a few reputed names for quick liquidity. Promissory notes, which are redeemable 30 or 60 days later are being encashed with local financiers at the cost of 2-3% interest per month. The financier gets his money from the reputed buying house after the stipulated days.

TEL-AVIV

Demand for rough is still very strong and prices continue to increase over last month's. Rough prices are perhaps more volatile than they have been in decades. Prices have gone up at all the major producers by approximately 10%: Alrosa, BHP, Rio Tinto, Harry Winston, etc. BHP's new roster of contract clients are now buying at a significantly lower premium above the spot prices.

There continues to be a price gap between rough and polished. In the past this deterred Israelis from buying but now they are determined to stay in the game for fear of losing position. On the other hand, most are concerned there will be a correction in the short-medium term. Premiums for DTC boxes surprisingly declined only slightly after the price increase – usually only 1-2%.

NEW YORK

As in the past few months only a few parcels of expensive Russian and Canadian goods around, none of which raises any excitement on the market in New York.

SOUTHERN AFRICA

Despite increases taking prices to the highest levels sightholders reported an increased level of activity in the rough market. There is an equal measure of activity in polished. Some of the boxes are reportedly better in terms of colours and models, especially 8grs and up.

On the new ITO's, reduced caratage was an issue for Botswana sightholders and most South Africans were very disappointed while realizing that sales of mines and reduced production mean inevitable lower supplies.

The IDMA Presidents gathering in Gaborone this week was well attended and considered a big success! Many issues about the business in Botswana were raised in the various presentations, but the still incomplete negotiations between De Beers and government meant clarity and conclusions were scarce. Botswana is now clearly on the map in diamond manufacturing, having moved beyond pure mining.



Polished

ANTWERP

Contrary to earlier predictions, the Antwerp polished market has gained even more momentum during and after the Basel show. March was a record month for polished diamond prices, with price increases over 4%.

The highest price increases were logged in 1-3 carat polished. Pointer sizes (dossiers) kept on moving well this month with inventories at their lowest since the crisis.

In better end smalls, sustainable supplies rather than price seem to be the prime concern for buyers. Most of the large conglomerates seem to be absorbing the price increases relatively easily.

At Basel, people reported a lot of B2B trading in +5ct polished, similar to what we saw in 2008. In smalls, orders from the watch brands are strong but more and more difficult to fulfill. In the last three weeks we have seen resistance mounting on polished prices by international brands and also retailers in developing markets such as India and China.

- Strong demand in 3ct. A bit slower in 5-7cts. Again very strong in 8ct up.
- 1-2 cts: Extremely strong across the board. Prices up by around 10%
- -6.5: Extremely strong demand especially in -2 and cleanish goods. Here prices are up by another 10-20%. In VS-SI, there is some price resistance.

TEL-AVIV

Polished business is good, but not hysterical, and it seems just about every diamond product is moving. Due to consistently rising prices, some are buying lower colours such as K/L/M instead of J in order to meet retail price points.

A large part of the business is within the trade: Israel - India. Not clear how much is currently going to the retailer and how much is for stock/speculation.

There seems to be a fundamental behavioral difference between Israelis and Indians manufacturing polished: the Indian buys a parcel of rough, manufactures it, and sells it immediately at market price thereby locking in a satisfactory profit. The Israeli buys and manufactures the rough but when it comes time to sell the polished, they see the cost for replenishing the rough (and polished) has gone up dramatically. Therefore they try to increase another x% on the polished to take that into account.

Israelis were generally pleased with Basel. This show has been challenging over the last few years due to the high cost to exhibit however this year was generally considered worthwhile.

Demand from the USA is good, however it is mainly from the large chains and 'big box' independents. The 'moms and pops' are buying for calls. There is resistance to higher prices but some need to restock and some buy for fear of higher prices later. So retailers are buying what they need but not as much as they would like to.

Demand from Asia is steady and strong with less resistance to prices than usual.

There is a fundamental problem to supply retail programs at the moment: retailers would like to lock in prices for 6 or more months however price volatility is such that for manufacturers it is nearly impossible to commit to a price.

- 3cts+: Increased movement in this area – good sales in Basel.
- 1.00-1.50 ct: strongest area - going to all major markets. Demand is from clean to pique with the usual preference for GIA certs. Availability is limited.
- Straight-edge fancies: Prices in this area have increased but not to the same extent as rounds. Princess and cushion moving well, especially with GIA certs. For example princess I colour/VS clarity and I/SI is moving well.

MUMBAI

Polished trade continues to do well, with stars and -2 continuing to command high prices due to shortages. While these prices are absorbed by watch houses, jewellery brands and inter-industry trade, it is of some concern that little is being absorbed at B2C levels.

Additional pressure is being put on the polished in circulation, as output from new rough will be much more expensive than what is available now. Polished prices have breached the 2008 levels with Stars and -2 selling at record \$1200 per carat. Pointers in I1 ranges are selling at prices of SI2. The only sticky area is +8 sieve which is 8-9 points polished.

Even in the larger sizes, a slowdown in manufacturing has meant shortages, resulting in prices getting pushed up.

- 1ct: Significant demand from Hong Kong, Korea and India has made this a sellers' market. Rap discounts are between 6-8% in this area, with very little availability of triple-ex goods in better colours and clarity.
- +0.70 ct Demand quite strong across this band, with SI to I2 in the range of \$1400-\$1800 moving the best. White is doing very well. Pique range experiencing a shortage, which is pushing up prices.
- 0.23 – 0.47 ct: This band is performing a little better than the previous month, but continues to be the laggard.
- +11 sieve: A distinct pull in this band with +8 out-performing -8 sieves. On average, an increase of 5%, with VS and SI performing much better than pique goods.
- -6.5 sieve: This band continues to perform the best, with a price increase of 7-8% in only one week! The \$950 price point is doing very well.

Ahmedabad

Following the closures of factories here, the Ahmedabad polished market traditionally filling the gap for cheap small sizes with average make, is facing a large scarcity. As a result buyers from Surat and Mumbai have to pay higher prices with -6.5+2, which was previously available for \$330 now selling for \$480, melee which was \$615 is now selling for \$835 and +8 for \$975.

NEW YORK

With unemployment now seemingly on the decline and profits reported at the S&P's 500 top companies expected to increase 15% this year on top of the 47% increase last year, there is a much more positive vibe about the US economy as a whole, almost to the point where you can feel it on the street.

The diamond market is particularly hot. The one area that is not moving as well as last year in the US is VVS quality stones. Overall, however, the shows in Hong Kong and Basel seem to have spurred the market to a new level. Whilst the Las Vegas show is still 2 months away, people are already fairly confident of another good show.

Jewellery manufacturers have started to re-engineer models in order to stop using the small sizes – particularly the 0.5pts and 1pts, where the prices have outstripped any achievable retail price point.

This week there was a local show, SMART, in Chicago. News from there suggests retailers in that region have lost a lot of their purchasing appetite. They are frustrated about the continuing increase in prices having already adjusted them twice, and are now trying to take it out on the suppliers. So far the consumer seems to have accepted the previous increases but the question is whether they'll accept another one.

The auction houses have also been enjoying the increase in demand announcing strong sales last year and anticipating near record prices for diamonds this year.

- +5cts: Demand is considered somewhat stronger this month than last, although much of this is as a result of the two recent shows.
- 2-3 cts: In demand. Higher premiums are being made on well-made stones, but there is demand at the right price for the weaker models. Oddly, there is a dead spot on 4cts polished. The sweet spot is G-I colours, VS-SI1 qualities. Here supply is limited.
- Fancies: Cushions in all sizes are doing well, with particular demand in 2.5cts stones. Pear shapes are strong even in 4grs. Models are however important. Even well made marquises are selling relatively well. There is also demand for other shapes.

HONG KONG

There is a lot of confusion amongst Hong Kong traders; buying goods today seems more difficult than selling them.

The multiple price increases have left people puzzled and there are big price differentials amongst traders for the same goods. Some have stockpiled goods for a few months and feel strengthened by events that they did the right thing.

The Shanghai Diamond Exchange (SDE) and the Diamond Federation of Hong Kong (DFHK) signed a cooperation agreement and will exchange member services, information and resources to speed up the development of the diamond industry in mainland China and Hong Kong.

Sotheby's kicked off the auctioning season with the "Magnificent jewels and Jadeite" sale on April 6th. The sale offered 329 lots, with an estimated value of \$60m. The top lot is a pair of DIF diamond pendant earrings, totalling 36.48cts by Harry Winston. There is also an extremely rare 1.92ct VS2 Fancy Red Diamond.

- 1ct: Good demand still in 1.00-1.50ct, especially SI. Prices are up by ~8-12%.
- +0.70ct: Prices have strengthened. 90pts are slower. Good demand for 80pts. Good demand for 3grs GIA certified goods
- 0.20-0.25 ct: 5 per carat sell well, but not the 4 per carat. Prices are up by ~4-5%.
- 0.10-0.15 ct: Area of shortage. Prices have strengthened by ~10-13%.

Retail



EUROPE

Demand in Europe was reported to be sluggish, except in Germany and the Swiss brands. The recent price increases have only exacerbated the slackening demand. Sales in Italy are slow and collection of receivables is becoming increasingly difficult. The same was reported in France in the lower end range. Fine jewellery on the other hand is doing well in France. Sales in Spain are almost nonexistent and the country is avoided by most jewellery sales people.

The Basel show was a strong one for watchmakers. Small specialty watchmakers and large and established brands were very satisfied with the outcome.

The Swatch group announced a net profit of 1.08 billion francs, an increase of 41.5% compared to 2009 and better by 6.4% than the previous record dating from 2007. Operating profit meanwhile leapt to 1.436 billion (903 million in 2009), resulting in an operating margin of 23.5% (17.6%). Net turnover meanwhile rose to 6.11 billion (+18.8%). The Watch and Jewellery sector, with a net turnover of 5.22 billion (+24.3%), recorded an operating profit up 52.2% to 1.22 billion. All geographical regions contributed to this exceptional growth, with Asia at the forefront.

The Bulgari Family, majority shareholder of the Italian House established in 1884 by Sotirio Bulgari, has decided to join forces with the LVMH Group in order to reinforce the long-term development of the Bulgari Group. The agreement was concluded during the weekend of 5 and 6 March and was approved unanimously by the LVMH Board of Directors. Bulgari shares currently held by the Bulgari family will become the second largest family shareholder of the LVMH Group. In compliance with the Italian Stock Exchange regulations, LVMH will submit a Public Purchase Offer at the price of 12.25 euros per share on the shares held by minority stockholders.

Following adjustments to its cost base (service and personnel costs trimmed by 7% and 4% respectively in 9M10/11), Damiani reached break-even at the EBITDA level in Q3 for the first time since the beginning of the fiscal year. However, the group was still modestly loss-making at the EBIT level at end September and Q4, whose contribution to full year earnings is smaller, is unlikely to fully offset the losses recorded in the first nine months of the year, in our view. We therefore cut our FY2011E and 2012E EPS to -€0.04 and €0.00 respectively (vs €0.02 and €0.08 previously) and expect the company to return to break-even in FY2012E.

USA

Signet Jewelers

Q4 of the 2011 financial year revenue increased 6.2% on the previous year to \$1.27bn. Same-store sales in the US were up 11.4%, but in the UK they were down 2.9%.

Full year figures for Signet in 2011 saw sales increase 5% to \$3.4bn. Same store sales saw a 6.7% growth in the US but a 1.4% fall in the UK. Overall profits increased 27% to \$200m.

Tiffany

Total sales during its Q4 of the 2011 financial year saw total global sales increase by 12.2%, with same store sales up 9%.

In the US sales increased 10% and same store sales were up 9%. Across the Americas, same store sales increased 8%, and in both Asia Pacific and Europe by 16%. Japan achieved a 1% increase.

For the full financial year, total sales at the company were \$3.09bn, up 13.9%. Comparable store sales were up 8%. US same store sales for the year increased 8%. Across the rest of the world at constant exchange rates, same store sales increased 14% in Asia, fell 4% in Japan and increased 18% in Europe.

Bidz

Q4 sales for this financial year rose 6% on last year to \$29m. For the full 2010 financial year, sales were \$104.8m, a fall of 5%. A loss of \$1.4m was also recorded.

HONG KONG AND CHINA

Price inflation in diamonds and gold has not put off the Chinese consumer. Retailers report good sales for the first quarter of the year, up 15-25% on last year, and price increases have been calculated through to the consumer.

More Chinese are keen to buy diamonds as an investment, especially since the government has put measures in place to cool down the real estate market and also because CIS stock market performance has been abysmal as well. At a recent wedding exhibition in Shanghai Expo, DJ retailers reported very strong sales of Diamond Engagement Rings.

Retailers remain positive and store expansion continues. There is also growth when looking at same store sales.

There is growing resistance to the continued price increases of polished, especially by smaller retailers. It also seems that in today's market of inflated prices, the on-line retailers are struggling. Under the current conditions they cannot get an advantage anymore as they also need to pay top dollar in order to get the goods. Lately, this has pushed the consumer back into the arms of the traditional retailer.

Although there is a common belief that prices can't go up much further, many people are confident about current levels and do not see it coming down again quickly.

INDIA

March has continued with the positive momentum of previous months. Previously the jewellery market slowed down in March, but this year the market has been upbeat and optimistic and has performed very well.

Despite the gold and diamond price rising significantly, the jewellery sales have increased for Indian retailers both in value and volume. The retailer's concern over the rising prices has increased, but the consumers are not showing resistance at the point of purchase.

On the export front, pricing has been the major issue for the jewellery manufactures and wholesalers because retail market of US and Europe are showing resistance to higher prices; whereas the Chinese market is responding to the price rise to a certain extent.



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