

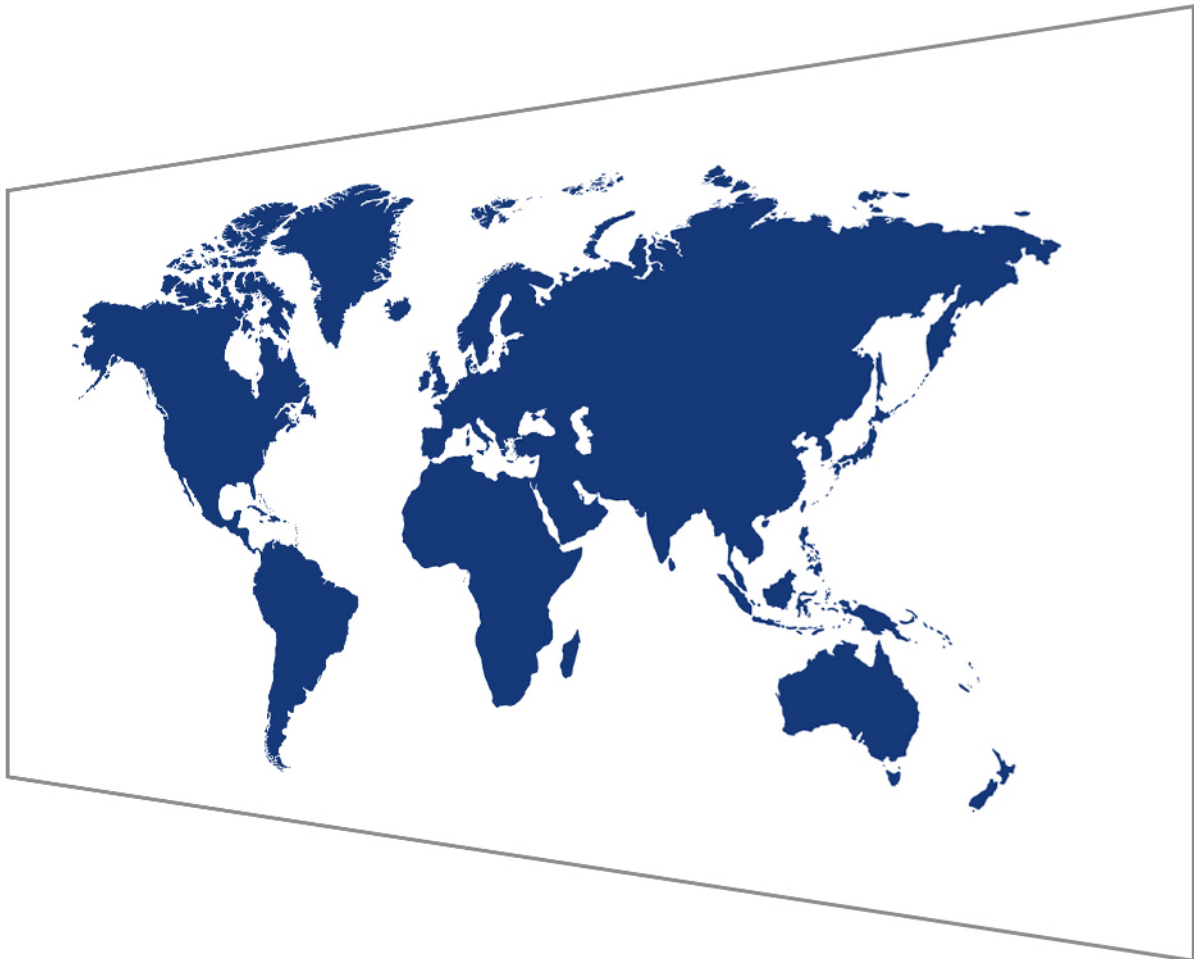


Bonas

Diamond Brokers & Consultants

Market Report

December 2011





Rough

GENERAL COMMENT

In the last three months, DTC's approach to the market's drop in rough prices from July's high has been broadly welcomed. It has preserved morale and allowed people to carry on manufacturing; the seven week gap between December and January sights will allow a lot of the fog to clear as we see how the US/Chinese consumer behaves over Christmas/Chinese New Year and whether the Indian domestic market will turn.

No one would claim the economic outlook for 2012 is rosy, but it may be that diamonds, either as a store of wealth or as escapism, will be able to outperform rational expectations.

ANTWERP

As we come to the year-end, the rough market has slowed down considerably.

Overall, there is not much rough trading going on. The small adjustments in DTC boxes had a positive effect on 2nd hand market quotes, which have improved by a few percent (not many transactions though). In general, open market goods sell much better than labeled goods, whether it is DTC, BHP or Alrosa.

Russian goods were reportedly more expensive this month by a couple of percent, but the talk is that an important price correction will take place in January. Traders in these goods are said to be currently facing double-digit losses.

BHP reportedly sold just over \$80m this month (excluding the +7ct stones), both up in carats, and in dollars. The average increase for both + 2ct. and - 2ct. sales is close to 5%. Some areas were down in price as well, for example the -3grs and run-of-mine. Here too traders are challenged in selling the rough.

Several tenders took place this month. Firstly, Bonas-Couzyn in Antwerp hosted the second Lucara tender for its Mothae production in Lesotho. Results were very good and all 28 parcels received multiple bids. Winning offers resulted in \$ 6.4m gross proceeds.

At Transhex the prices of melees were reportedly significantly down, but the overall value was boosted by the sale of a few large stones. At Petra, the second sale of Finsch attracted a big attendance. Fewer goods were withdrawn compared to last time.

INDIA

2011 closes on a relatively bearish note due to negative global sentiment. This is compounded by a bleak Indian environment, marked by political deadlock, a surging fiscal deficit, a spiraling cost of living and scant foreign deficit inflows.

November and December have been especially painful, with retail flat lining, polished sales drying up and rough slowing significantly. As a result, stocks are inching up slowly, and expectations of additional rough from Zimbabwe and Angola in the first quarter are adding to the anxiety. In this atmosphere, buyers are cautious about new purchases, as there may be further erosion of polished prices.

Manufacturing centers saw an extended lull post-Diwali, with many staying away due to the marriage season, which lasted till December 7. Factories are now up to ~70% capacity in larger units and ~40% in smaller ones. Many experienced workers are turning into entrepreneurs, as they travel in groups to procure rough, especially at African tenders where



they buy larger stones. These are then manufactured in their small units or sold after planning.

Smaller manufacturing centers are struggling with the no-show of workers after Diwali. The situation in Ahmedabad is unreliable, as only big contractors who are paying market rate plus bonus have been able to attract workers. A small price rise in Argyle goods has made life difficult for dealers in Ahmedabad. Bhavnagar is busier than Ahmedabad.

TEL-AVIV

Despite improvement in demand for polished in the US, and the optimistic atmosphere during sight week, polished prices are not improving and the fear is that after the season's sales the pressure on prices will grow, forcing them downwards. The financial crisis in Europe and the increase in stock during the last 2-3 months have reduced the demand for boxes a lot and even traditional buyers are pushing prices down and credit terms up. (60-90 days)

The Indians are back in the market after Diwali but most buyers are small traders who are mainly interested in assortments.

SOUTHERN AFRICA

As usual in December the sights were pretty small and most of what was bought is likely to stay in safes until after the Christmas holidays. There were some "buybacks" (portion of boxes not purchased from DTC). As in London, the most difficult area seemed to be the +10cts.

In all three countries it has been an eventful year and the outcome of the CPQs is eagerly awaited. Inevitably, as aggregation approaches, and then the move to Gaborone, Botswana will become the centre of attention. There is much to be done in terms of upgrading or creating infrastructure.



Polished

ANTWERP

Activity is quieter due to a combination of the season ending and the bleak economic situation. People are not motivated to buy goods for stock. The last month was generally decent for most companies with fair to good demand from all markets, except India and China. Focus of activity was in VS – SI quality while trading in cleanish VVS goods has weakened. A lot of price pressure is being noticed in the smalls (mid- to lower end), where offices have reduced prices by 3 to 5% on average compared to last month.

Traders have mixed opinions about the outlook for next year as a lot depends on external developments. European traders in general lack confidence in the € and this might weaken buying power considerably next year. The more optimistic voices expect a flattish first quarter.

TEL-AVIV

November was better than expected for some, but by no means for all. The trend we saw in previous years for American retailers to buy at the last minute has become more pronounced. Everyone is hoping for a good retail season following an encouraging Thanksgiving weekend.

There is some demand from Asia (but not strong) as we are now at the height of the Chinese New Year season, coming relatively early this year on January 23. After a few months of sitting on the fence and pushing down prices, retailers have no choice but to buy at current prices.



Overall the polished market is mixed: for some decent and for others quiet. However no one has a clue what will be in the short, medium or long term. Volatile stock markets and troubled economies continue to have their effect. Diamond companies from manufacturers to retailers are conservative in their purchasing and trying not to buy more than they need. The biggest concern now is profitability.

MUMBAI

Trade levels are subdued compared to the previous month, with an estimated 15-20% slow-down. This is reflected in slow consumption reported both locally and in growth markets like Hong Kong and China. The only demand being registered is in medium to low quality goods. However there are many complaints that fresh stock is hard to find. Some say the shortages are a result of low attendance in factories due to the marriage season; others put it down to sale tactics. Distress sales are still few and far between, but most are tightening their belts and preparing for a tough Q1 in 2012.

NEW YORK

The bullish market that was witnessed prior to and just after Thanksgiving has calmed down somewhat, but those companies selling to the stronger retail chains and independents still see demand for items.

Many companies have noticed that retailers, having reduced colours and qualities, are now buying smaller diamonds. An example of sales to majors has seen both solitaire and parcel average sizes fall approximately 20%.

Shortly after Thanksgiving the New York market was relatively confident that business would be OK in 2012. However, in the last couple of weeks that sentiment has weakened and is being replaced by increasing uncertainty.

HONG KONG

Retail figures from Hong Kong are good but the trading market has gone very quiet. Most clients, some with important positions in this region, report a significant drop in polished trading compared to the first nine months of the year. The consensus is that retailers somewhat overbought earlier in the year in anticipation of further price increases.




Retail

EUROPE

First feedback from European retailers in low and medium end is a decline in traffic and sales compared to last year. The high end seems to be doing 'okay'. Focus of spending however is on watches rather than diamond jewellery. The following trends in retail have been noticed:

- Volumes per item ordered by retailers are down
- Strong pressure to reduce costs wherever they can
- Lack of new trends and products in the stores

Swiss brands continue to buy from their regular suppliers, but have slowed down considerably on their additional purchases. Starting January 1, Swatch Group will begin to cut back, and possibly eventually end, the sales of mechanical movements and other watch components to its competitors (many of them small and without the financial wherewithal to produce their own movements) to concentrate on producing watches with higher profit margins and to make sure it has enough supplies on hand for its own brands. Swatch's move is still being challenged in court by 9 watch companies. The plaintiffs predict that several companies will disappear



because they have few other options for the parts, which must come from Switzerland to keep the lucrative "Swiss made" label. According to some sources, this result could be as wrenching to the Swiss watch industry as the arrival of Japanese digital watches, which almost led to the industry's collapse in the 1970s.

USA

Sales over Thanksgiving weekend and on Cyber-Monday which followed exceeded everyone's expectations. Total Black Friday sales were estimated to be \$11.4bn, up over 6% on the previous year, and Cyber-Monday sales up 22% to \$1.25bn. Electronics were rated as the most purchased item. However, the level of discounting which undoubtedly drove consumers into stores was pretty deep.

Market talk suggested that the major diamond and diamond jewellery retailers in the US fared very well. The independent market was more mixed; the strong ones doing well, the weak ones not so well.

HONG KONG AND CHINA

Wholesale demand is slow as retailers are cautious about building up inventory. Diamond jewellery retail sales have been disappointing since the golden week in October. There are excess goods in the market and we need a decent Christmas and Chinese New Year (this year on January 23rd) in order to get things moving again.

Retail spending in China moved up slightly to 17.3% on a year-ago basis in November, with gold jewellery (not diamond jewellery) sales up by more than 40%.

INDIA

The retail dream in India seems to have lost its allure, with everybody from consumer durables to luxury retailers struggling to keep market share. Diamond retailers too have been affected. Diamond jewellery sales at retail are estimated to have grown by approximately 10% in dollar terms for 2011 (however the dollar has gained 19% since March), with actual units sold being far lower than previous year. Those in the know estimate same store sales to be down by an average of 25%. The west of India (Gujarat and Maharashtra) is still registering growth, but the rest of the markets have seen a severe downturn.

Gold jewellery sales too are trending down. Year-on-year gold demand in India went up 15% in tonnes and 46% in value (US\$) this quarter, with most of the purchases have been in the form of gold coins and biscuits as Indians continue to strongly believe gold offers the best protection against inflation. Most major gold retailers confirm a slowdown in jewellery. Unofficial reports say jewellery turned approximately 4 times in 2011, compared to 6 in 2009.

Most Indian retailers are going back to the drawing board. Fancy shapes, rose cuts and SI goods are being used to hit the right price points at retail. Some Delhi-based retailers are also even lowering caratage from 18k to 16k.



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