

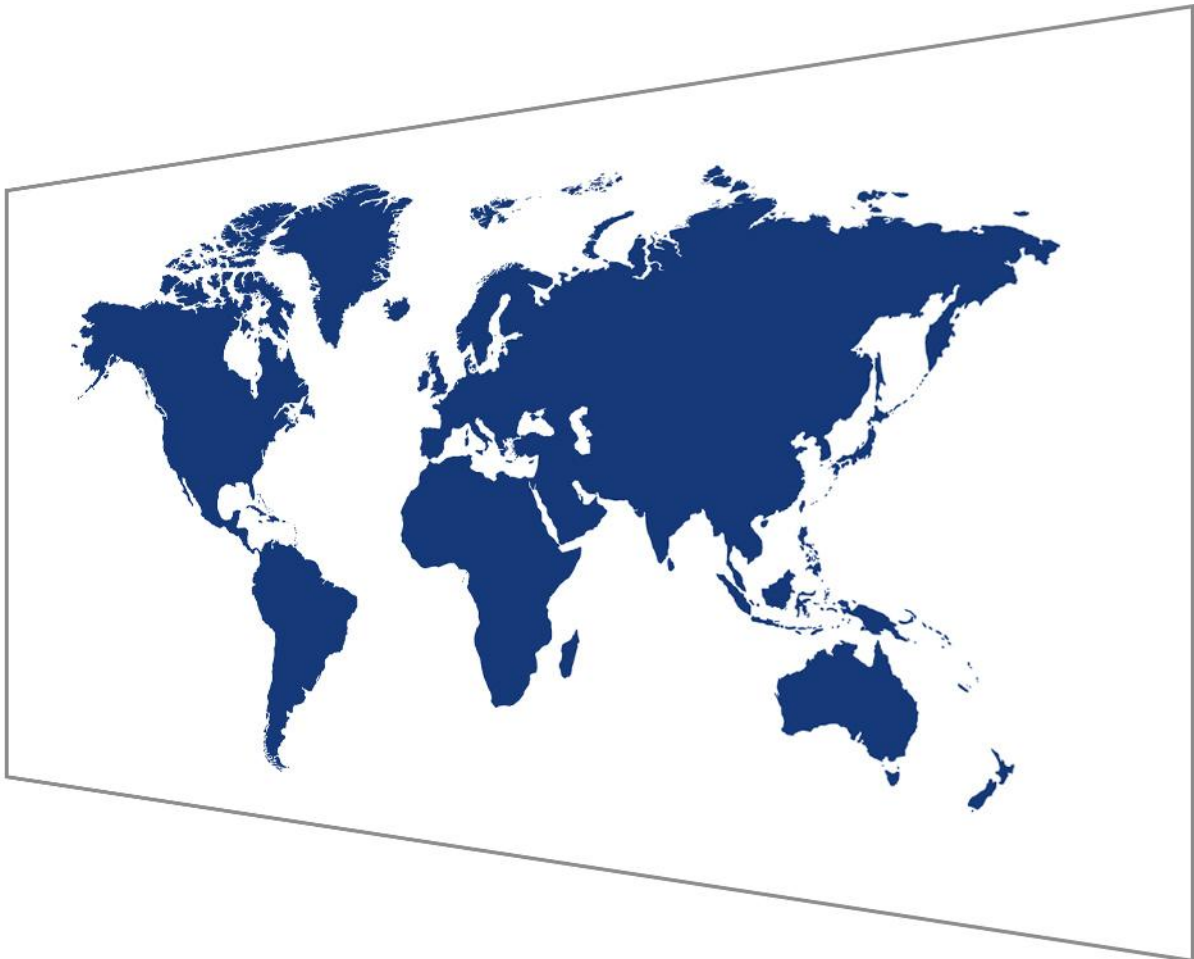


Bonas

Diamond Brokers & Consultants

Market Report

January 2011





Rough

GENERAL COMMENT

Nearly all diamantaires were satisfied with the outcome of the Christmas season, while Indians in particular report very strong business. This continues to be reflected in hot rough demand and continuing strong premiums. Small goods, especially for Europe and the Far East, are in fierce demand and manufacturers are casting around for production capacity. We find the current unchecked 'future market' in rough predictable and a little worrying.

The year has started well, and the polished trade is optimistic for the first half, which is probably as far as one can legitimately look down the track. The good thing is that demand is no longer limited to two or three markets, and despite a few warning signs from the Chinese economy, we expect a steady year of establishing a more normal level of demand after 2010's restocking.

ANTWERP

Rough trading in January resumed at full bore. Feedback from the Christmas sales season was positive and also at the start of the New Year polished demand continued to be good and prices strengthened.

This has given confidence to rough buyers who have been obliged to pay higher prices in order to get access to goods. As a result, premiums on DTC boxes are strong and average between 7% and 15%.

Results at the latest BHP sales have also exceeded expectations. Reports indicate the +2ct. area fetched 4% more, and the -2ct. area fetched 10% higher prices. The total amount sold was up by about 4% in carats, but 11% in value. On the secondary market these goods trade at no or marginal profit, and therefore there is an increasing number of BHP clients unhappy about the term-contract. There is an option to opt out in two months.

Russian goods had already appreciated substantially at the end of last year. The goods are still in demand on the secondary market, and we get the impression that Alrosa is pushing out more goods again through tenders rather than direct sales.

All of the above sounds incredibly positive, but there is a caveat. As was the case in spring 2008, there is now a lot of polished trading at B2B level but it does not necessarily reflect consumer/retail demand.


Also, in spite of increasing polished prices, the gap remains. By definition, fluctuations in rough are more violent and happen faster. Therefore, margins at manufacturing level are still very much under pressure, and this remains a worry for that sector.

MUMBAI

The Indian market was abuzz with rumours of a steep hike in rough prices, which led to a lot of pre-sight box trading. Premiums held up during and after sight week as well. The trend appears likely to continue for the February sight as well.

Rough premiums in some areas seem unrealistic, with a disconnect with polished continuing. These high premiums continue however for the following reasons:

1. Illusion that the first sight of the year has better assortments (although many sightholders believe that the improvement is not significant)

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2. Many small to medium level manufacturers did little business in the last quarter of 2010 and hence are hungry for rough
 3. Most people have been able to offload their stocks during the season and hence would like to re-enter the game again
 4. Not much outside rough is available in the open market and what is there is very expensive.

All this has resulted in several serious manufacturers staying away from 2nd hand DTC goods. Another point of discussion is the shortage of polished in the better end of Stars and Melee. Due to this shortage, the price increase in the -11 area of rough was absorbed by manufacturers.

As a result the challenges in profitability in this area, especially with secondary manufacturers, are compounded.

There is much anticipation of the KP certified Zimbabwe rough, and manufacturers and brokers have already started putting prices and bookings on the parcels.

OTHER INDIAN CENTRES

Ahmedabad with its 60,000 workers is facing an acute shortage of manufacturing capacity, due to India's rising inflation and labour rates still being very low. This is despite the salary rise early this year. About 40% of the units are still under seal due to improper facilities.

This centre was exclusively manufacturing Argyle rough, but that is now reduced to about 15% of the total production input. Now one sees brisk activity in Australian 7/5, Grey Rejections, Argyle MB/Clv (\$56) browns, Russian -9+7 and BHP Browns -11+5 which caters to -2 and +2 polished. They also now manufacture Catoca and DTC rough. Polki manufacturing is doing well and mostly Argyle Browns are used, as the colour significantly improves after polishing, vis-a-vis other rough.


The situation in Bhavnagar is little better than Ahmedabad with a workforce of around 100,000 workers. At the moment Rose cuts, single cuts, Velendi/Polki (rough piece given shape for jewellery) is doing brisk business. 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

Demand for rough is strong with premiums higher in January from all rough sources:

- **Alrosa** goods coming into the market are fully priced even though the select few buying directly from Alrosa may not necessarily be turning a profit;
- **Outside** goods in Antwerp and Tel-Aviv are also more expensive and there is a large number of potential buyers (mainly Indian). There is however a shortage of goods available;
- **BHP** spot prices increased several percent on average (See Antwerp)
- **DTC** boxes are highly sought after with premiums quoted above last month's. However there is far more talk than actual transactions.

It is difficult to determine how much of this demand is 'real' and how much is speculation. Polished demand is healthy and prices are higher after a better-than-expected season, but there is concern polished prices will not be able to keep pace with rough. Manufacturers are currently struggling between the desire to 'stay in the game' and staying real about rough-to-polished calculations.



Prices rose steadily in the first half of 2010 and it remains to be seen whether we will see a repeat of this in the coming months. The difference of course between now and then is that in an increasing number of rough areas prices are close to or above the peak prices of mid-2008.

NEW YORK

Demand for rough is increasing, even in New York. A number of companies based in the city, that have not been interested in rough for some time, are now looking for parcels. The problem is little rough is traded now in New York. That said, one US based sightholder has been offering goods on the market, but the premiums being asked have put those looking for goods off.

SOUTHERN AFRICA

Sights were generally well received. Improvements have been reported in some of the box assortments, for example the Chips 4-8 grs. These were very welcome.



Polished

ANTWERP

The Antwerp polished market is strong at the moment, especially in small sized polished (-11) where a sourcing problem is felt due to requirements being so specific. Overall inventory levels are low and the pipeline is being restocked. Most traders report the demand in smalls to be across the board, however some say it is mainly focused in the two extreme ends of the market; better end and SI quality down. Prices are moving up by 3% to 5%. Many manufacturers in smalls are trying to expand their production as most expect the positive momentum to last at least for the first half of the year.

While there is still a small price difference with Bombay polished price levels at the moment, this is temporary and due to the delayed effect of the Antwerp Christmas closure. Overall, prices of polished are up by 4% to 5% in comparison to the pre-holiday market.


The situation is less strong, though still good, in +11. Good demand is reported in pointer sizes, however areas are more specific here. Polished manufacturers anxiously follow the rough market price trend as it will cream off their profit margins sooner rather than later.

- Very good demand for +3cts with prices up 4-5%.
- 1-2 cts also doing very well: 2cts SI+ as well as 4gr and 5gr in VS quality, H-colour. SI quality moves well too.
- Cushions sell well in larger sizes (1.25ct+) and prices are up by 3% to 4%. Good demand for well-made pears and marquises.

TEL-AVIV

January was a strong month for polished and many companies are pleased with this month's sales volume. Some less attractive items languishing in stock were eagerly disposed of. There are however a few major concerns:

1. Profitability – both on manufacturing and polished trading. Prices of rough and polished have been rising rapidly and retailers appear willing to pay more but not without limit.

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2. Stock replenishment – be it rough or polished purchases. Polished prices are stronger locally and even more so in India. Israelis travelling to India find it very difficult to buy polished as asking prices are very high. It is not clear if the shortage of polished in India is real or artificial.

Demand is mainly from the East and the US, with Europe quiet for the moment. Wholesalers are restocking to supply retailers post-season.

2010 was a good year. Sales were significantly higher than expected for the year after a very tough 2nd half of 2008/1st half of 2009. Manufacturers generally found the first half of 2010 to be profitable with the second half less so.

- Increased movement and higher prices for +3cts. Demand appears to be a mix of consumer demand, investment purchases, and speculation.
- 4-6 grs is the strongest area with demand pretty much across the board. GIA certs preferred.
- Good demand for pique princess (especially I2-I3) in all sizes. SI moving well in 4-6 grs. Clean princess slow. Cushions and emeralds also moving relatively well.

MUMBAI

There are very few polished businesses to be bought in the local market, so a growing number of wholesalers are travelling to Antwerp and Tel Aviv to fill gaps in their inventories at prices which some say are competitive with, if not lower than, prices in India.

- +1ct performing very well. Sightholders are trying to hold out for better prices and letting deals fall for 2%-3%. On the other hand, they are finding it difficult to source large businesses at reasonable prices. Western buyers too are finding it harder to get 'deals' in the Mumbai market.
- 0.50 – 0.69 ct Pique goods are moving exceedingly well. Prices too have seen an increase of 2%-3%, but this is not in line with the increase in rough.
- Sales of +6.5 and -6.5 are brisk with demand greatly exceeding supply. +6.5 previously worth \$450 can fetch as much as \$650, depending on the desperation of the buyer. -6.5 is fetching up to 20% more than last month.

NEW YORK

Almost all companies in New York agree that the season was significantly better than had been anticipated. As a result, companies are sitting on low stocks and are searching to replenish them. Added to this, returns are expected to be lower than normal as people believe that retailers bought sensibly for the season.

Demand is strong in a lot of areas, but particularly so in triple excellent makes. With stock being hard to come by, companies have taken to re-cutting weaker makes to get the triple excellents.

With memo in decline and credit terms tighter than they have been for some time, at this stage, there seems to be little but optimism on 47th Street for the year ahead.

- +5cts excellent makes remain fairly strong and prices firm. Demand for regular makes does not match that of the top end.
- 3cts also moving across the quality and colour spectrum
- Square edged fancies are in good demand. Pears are also in good demand. Ovals and marquises are somewhat weaker.



HONG KONG

Trading in Hong Kong continues to be strong. There is a perceived shortage in the market and this has stimulated B2B trading. After a slower period, GIA dossiers now seem to be picking up again and prices have strengthened.

Hong Kong is getting ready for Chinese New Year and spring festival. In 2010 it was mainly the mainland Chinese consumers that pushed sales for Hong Kong retailers, let's see whether that repeats itself this year.

The Hong Kong show in March 2010 was a very important indicator on how the market would behave in the aftermath of the crisis. Again this year, that show will give us a first indication on the direction this region will take.

- Good demand in 1.00-1.50ct., especially SI clarity
- 0.50 and 0.75 ct (GIA) are selling well while 0.60 and 0.90 ct are not.
- 5pc sell well but not 4pc



Retail

EUROPE

Luxury and Swiss brand houses are ordering strongly at the moment as they try to adjust their stocks after the sales of the past months. The programme buying in smalls from high end brand houses is in very precise areas and fulfilling these requirements is difficult at the moment. The market is optimistic that demand prospects in this area will remain bullish for the first half of this year.

For many the VicenzaOro fair in Italy last week went better than expected and people returned from the show in a happy mood. The fair started very crowded but quietened down considerably from day 3. A healthy number of jewellery orders was collected. Most exhibitors focused on selling what they have; hence no real innovative products were noticed. Buyers were reluctant and cautious to pay higher diamond prices, a process that will have to be implemented step by step.

Last week, two watch fairs took place in Geneva: GTE (Geneva Time Exhibition) with 38 exhibitors, mostly small independent companies. The show was described as a phenomenal success exceeding people's expectations. The larger SIHH (Salon International de la Haute Horlogerie), organised by Richemont, had 19 exhibitors who use the show to present some of their newest products in advance of the major Basel watch fair in March. Together the two shows draw some 20,000 visitors. Americans seemed to have come back in force, alongside people from Asia (except Japan).

USA

Jewellery retail sales in the U.S. grew by 10.4 percent in December. SpendingPulse noted that the rate of growth was the first time since June 2010 that the jewelry sector enjoyed double digit gains. The increase for December was primarily driven by strong performance across independent jewelers as well as the high-end retailers.



Tiffany

In the two months to 31st December 2010, Tiffany reported the following sales results:

- Net global sales increased 11% to \$888.5m; comparable store sales saw an increase of 8%
- Sales in America (including South/Latin America and Canada) increased 9% with comparable store sales up 7%
- Internet and catalogue sales in the region increased 8%.

Signet

Total sales for the holiday season (9 weeks preceding January 1st 2011) were up 10.4%. Same store sales for the holiday season rose 8.1%. For the 48 weeks preceding January 1st 2011 comparable store sales were up 6.6%.

- The US division was up 12% for the 9 week period and 9% for the 48 week period (comparable store sales).
- The UK division was down 4.2% for the 9 week period and down 1.7% for the 48 week period (comparable store sales).

Zale Corp.

For the last 2 months of 2010 the company reported that comparable store sales rose 8.5% on the previous year. Same store sales in the US rose 7.5% whilst Canadian sales rose 10.2% at constant exchange rates.

HONG KONG AND CHINA

The November record has been officially broken with inflation raising 5.3% this month, in reality prices of food and staple goods have risen by a double digit figure. In the meantime the Chinese government continues to take measures to tame the property market and second home down payments have been raised to 60%.

For diamond jewellery retail, this high inflation combined with high gold prices, have pushed the consumer towards more affordable jewellery, which usually means a downgrade in quality. Indeed, the range of polished continues to expand.

On February 3rd China moves from the year of the Tiger into the year of the Rabbit. Retailers in general are optimistic and at B2B level our industry will continue to benefit from a continued expansion of the retail network. Right now, business is good and many people buy now before an expected price increase after CNY.

INDIA

The domestic market is doing well, with sales picking up, particularly after the decline in gold prices. In addition the Indian economy looks pretty robust with ample foreign exchange and buoyancy in both the stock and real estate markets. Retail sales have improved considerably in the Indian market. Everything really depends on gold prices. Any wild and volatile fluctuation in gold prices creates a kind of paralysis in sentiment. Nevertheless, DJ sales have picked up in comparison to gold jewellery.



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