

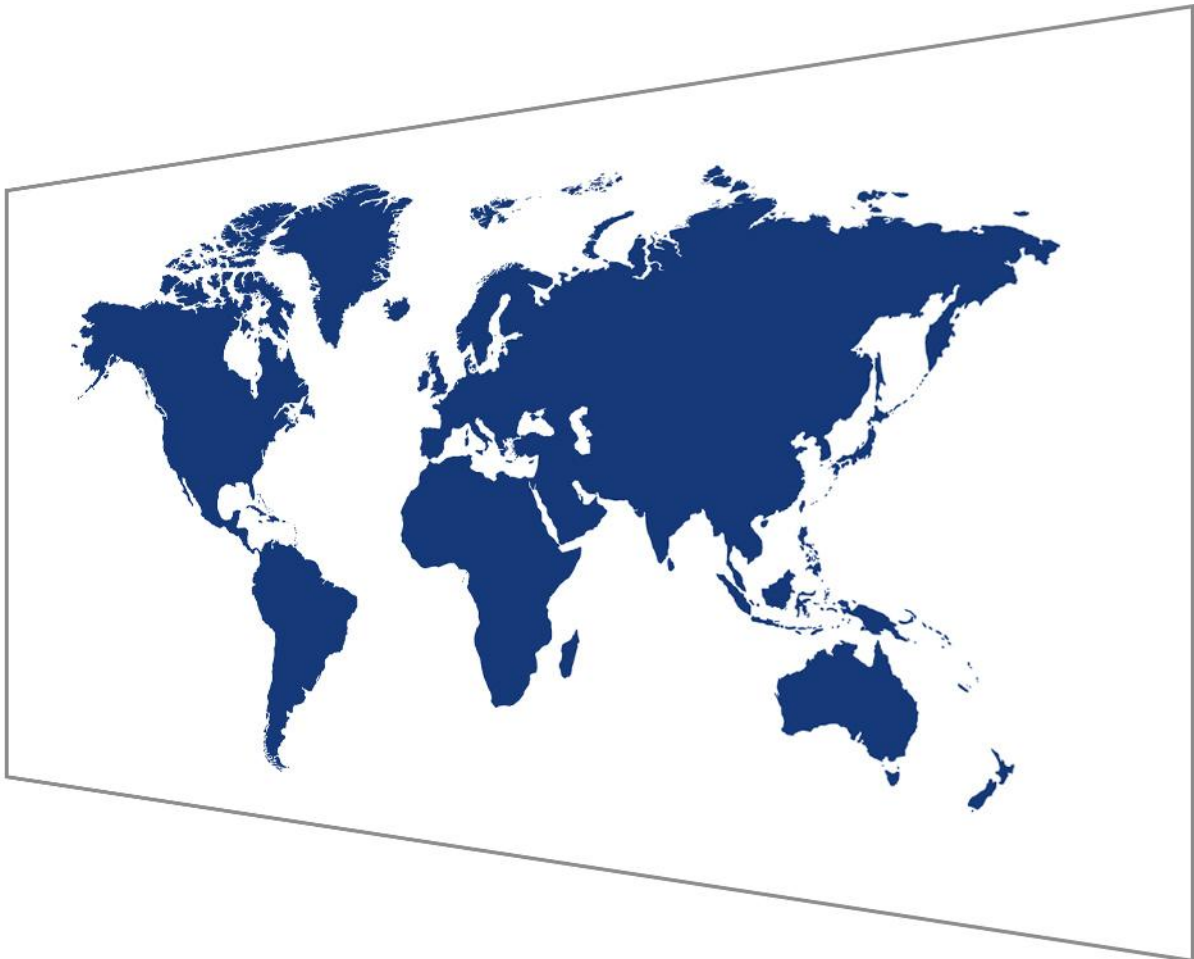


Bonas

Diamond Brokers & Consultants

# Market Report

July 2011





## Rough

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### GENERAL COMMENT

Most markets have slid into holiday mood. The further increase in prices at the DTC July sight was accepted as almost routine, though privately most sightholders were doubtful that current conditions will be sustained long enough to allow them to pass it on in polished. Demand for polished has definitely eased – though how much this is seasonal is not clear – and some areas of rough saw stand-offs between sellers and would-be buyers immediately post-sight. It is evident that liquidity is becoming increasingly an issue, particularly in the Indian market. No-one complains about the current state of the diamond market, but there is widespread awareness and concern that it has become a parallel universe to what is going on in the global economy, and particularly in the Western Hemisphere.

### ANTWERP

In the first half of the year the rough diamond market has gone from strength to strength. Even though rough prices have been constantly rising since mid-2009, the most spectacular growth has been achieved since January this year with prices gaining about 10% on average month after month and some items more than doubling over six months. All producers have benefited and were strengthened in their pricing policy by strong premiums paid on the secondary market. In this period we have also witnessed the most dynamic pricing ever from the DTC.

Two elements are fundamental to keeping this momentum going: solid polished sales and access to funding. In our opinion, both are somewhat doubtful at the moment. Many people in the industry will agree that the run in polished has been equally spectacular in the first six months of the year. The acceptance of further price increases at retail levels is now meeting with more resistance. Also, although several retailers, including international brands, have given up on margin in order to cope with the avalanche of price increases, there is clearly a limit to how far they can continue with this.

Tighter liquidity in the market is being reported by most rough dealers. Cash business in rough has become a rarity. There is less appetite for goods and premiums are down 3-5% compared to last month. Dealers in second-hand Angola goods are having to take double digit pastings.

Russian goods also leapt forward substantially and reportedly gained approximately 16% in price. Certain items, e.g.-9 sizes, increased over 50%, thus taking away the prevailing premium for that box.


So far, there has been no discernible price effect on cheaper ranges following transactions of KP-certificated Zimbabwe goods in Dubai.

The buoyant rough market is sometimes in stark contrast with other economic realities globally. Also it has been largely trading based and certainly not entirely polished driven. Not all rough sold actually ended up on polishing wheels and therefore we may experience a perceived shortage in certain areas of polished. Caveat emptor..et vendor.

### MUMBAI / SURAT

The eagerness for rough that was seen until a month ago has petered out. Replacing this is a widespread nervousness as many are holding high rough inventories bought at high prices, along with high polished inventories that are a product of expensive rough, and whose sales have slowed down. A frequent statement on the market these days is "I hope we aren't heading for another 2008."

Premiums have steadily headed down in most articles this month, and diamantaires are hesitant to strike spot deals. Even those traders who are cash rich are waiting for the situation to settle. Very few genuine manufacturers are buying goods on the secondary market right now.



The result of this inter-trading is that a lot of expensive rough inventory has built up, helped by increased BHP and Russian sales while there is also a certain amount of KP-certificated Zimbabwe goods entering the market. Polished sales on the other hand have slowed down. Many buyers feel there is no shortage of rough for the foreseeable future, and the market seems to have turned. It is a buyer's market in polished. Manufacturers will be challenged to raise polished prices and therefore rough price increases will directly affect bottom lines. A further problem for manufacturers is the loss of manpower. With the monsoons healthy, there has been further attrition. Ironically, factories are now surviving because of less caratage and more value.

## **OTHER INDIAN MANUFACTURING CENTRES**

Ahmedabad is struggling to keep pace with other manufacturing centres. Though the number of workers has increased after the financial meltdown, there are still not enough to manufacture the increased caratage in hard-to-process Argyle goods.

Combined with a shortage of labour and less demand for polished of Argyle origin, these goods continue to remain out of favour.

Bhavnagar on the other hand is doing fine with smaller sizes in Russian, BHP and DTC. Even the small taper-baguette and single-cuts are doing fine.

## **TEL-AVIV**

Tel Aviv rough market has cooled somewhat and reacted this past week to the price increase with a 3-4% decline in premiums. The reasons for this are:

- Summer vacation
- The demand for polished has weakened, mostly from the U.S., but also from Hong Kong
- Indian demand for rough was very weak (liquidity problems?)
- Despite expectations, Rapaport did not change prices
- Most outside goods now seem similarly priced to DTC.

At the end of the summer vacation there is another sight and cash flow may determine the strength of the market. Also, if polished prices do not increase the manufacturers will have to decide whether they want to sell at a loss or not. The last few months have seen increased speculation as people have tucked away both rough and polished in the safe.

Time will tell whether we are at the beginning of a market change or just experiencing a temporary accumulation of reasons that cause the market to soften.

## **NEW YORK**

There have been some Canadian goods on the market in New York. However, there are very few people that are interested in buying them and those that have seen them found them very expensive.

## **SOUTHERN AFRICA**

The price increases were expected and to some degree still welcomed for two reasons, 1) good activity in polished sales and 2) good premiums still exist on rough. Despite some Zimbabwean goods having made it into the market, rough prices still remain buoyant all round. The main worry, which has been reported previously, but has now become a serious problem, is the actual reduction in volume. Reduction in mine production due to sales of mine assets is making the problem even more serious in South Africa. Clients have to look outside the De Beers group for additional supplies. But the problem is that these are neither regular nor reliable. Tender prices are way above the norms. The ongoing labour strikes in the mining sector (including diamonds) in South Africa do not help the situation in the short term!



## Polished

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### ANTWERP

There is polished movement in Antwerp (at old prices) but activity is slowing down by the day as the market is about to leave for the summer holidays. Traders at the moment are only buying goods for which they have orders and returning other goods to avoid stockpiling at all costs during the vacation.

The upward trend in polished has been mainly driven by clean and small goods (and pointers in selected areas), leaving other ranges well behind, unable to follow the same growth. SI-quality seems to be catching up this time-lag at the moment. Demand is hot due to buyers wanting to benefit from the large price gap with VS goods.

Polished traders are skeptical about their ability to pass on the new rough price increase. They will take the call on this after their return in August, allowing them to crosscheck market feedback from other centres first. Main reasons for buyer resistance are:

1. Significant quantity of polished is expected to flow to the market in the next two to three months as a result of large amount of rough sales and inter-traded rough which will finally be manufactured (if enough labour is available).
2. This has pulled in large amounts of liquidity.
3. New expensive polished will reach the market at a time when demand starts to dry up.
4. Affordability at B2C level has not gone up and current economic indicators don't inspire any confidence.

### TEL-AVIV

Polished sales in July are significantly lower than in June, leading traders to speculate whether it is due to the higher prices in rough or simply seasonal as Americans and others are on holiday. Demand is, however, far from dead - especially from China. Polished stocks continue to be low and manufacturers are working on replenishing stocks in time for the upcoming season. Israelis flying to Mumbai to purchase businesses are not finding a uniform approach amongst Indian sellers: prices range from high to absurdly high as the latest price increases are factored in differently. Liquidity/cash flow is becoming an issue in India and their prices/propensity to sell are clearly correlated.

Programmes, including branded programmes, have become very difficult to supply in 2011 as these are generally priced in advance, leaving the supplier with two unpalatable options:

1. Sell the polished at break-even or loss, depending how many months in advance the prices were determined
2. Not supply the programme, leading to a loss of face and deterioration of relationship with strategic retail clients

Fancy/crystal shaped rough is made mainly as rounds leading to low polished stocks in these areas; shortages may arise later this year.

### MUMBAI

Polished trade in Mumbai has been heavily hit by the recent spate of terrorism in the city, keeping overseas buyers away. This is worsening the market situation, which as we reported last month, was already experiencing a slowdown. The market is starting to tilt towards the buyer.

The excitement and buzz that we experienced pre-IIJS is missing this year.

On a year-to-year scenario however, the carats exported remain unchanged at 5.12 million carats, reports GJEPC. The average price per carat according to them went up only by a dollar to \$434.26.



## NEW YORK

New York is back from its summer break, with polished traders showing a little more caution than was the case beforehand. There is concern that further speculation will lead to instability as prices will not be able to be sustained. That said, there was some surprise that Rapaport did not raise his prices this last week as some feel his list does not reflect where polished is and the cost of replacing goods.

Specialists in non-round items are facing a big dilemma – continue to cut specialist polished product and service their established customer base or start cutting rounds in order to sell at higher prices but develop a new clientele.

On a macro-economic level, the US debt crisis is not outwardly affecting the New York diamond industry, with most of the impact being felt on the stock exchange. There is widespread belief that an 11th hour short-term solution will be the outcome, only for the issue to reappear either side of the presidential election.

## HONG KONG

Business has slowed down after the Hong Kong show that took place in the last week of June. This is partly seasonal, but also the multiple price increases seem to be having a paralyzing effect on business activity. Resistance to new prices is building up in a big way.

In the meantime, numbers have become very big and companies need to carefully watch their cash flow positions. Price differences of 8-10% between different traders often are a signal that people need to force sales in order to rotate, please the banks and keep their credit lines secure.

Demand for parcels rather than dossiers in the pointer sizes continue.

Can the uptrend in demand and prices continue into the second half of the year? At the moment traders seem rather optimistic as demands keeps coming from the Chinese and Indian retail markets. The September show will give much clarity on the direction of the market.



## Retail


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### EUROPE

Diamond jewellery retail activity in Europe remains soft with lackluster demand across the markets, except for the very high end segment (€10,000+). The low price point category (€200 down) seems to have vanished completely and been replaced by alternative metals such as plain silver and brass.

Payments are a general problem in Europe, now also affecting financially solid companies. Liquidity is tight and suppliers (especially in the cheap end of the market) are squeezed and put on-hold by customers, awaiting payments from their customers first.

Germany and Turkey perform better than the rest of Europe. Italy is described as dramatic in terms of demand as well as receivables. Demand from Switzerland remains robust. The jury is still out whether they will absorb a new price increase though. Some better end (non-Swiss) customers decided to go down in quality after being informed about the new price increase. Swiss watch exports rose 15.9% (CHF 1.58bn) on the year in real terms in June, driven by continued strong sales in greater China, according to the Swiss customs office. In nominal terms, the gain was 10.1%. The increase was slightly lower than in May (+40% in real and 31.6% in nominal terms). YTD watch exports are up 23.2% (CHF 8.7bn), with analysts forecasting the industry is on course for a record year in 2011. The upper price segment was particularly buoyant in June. Currency pressures from continued Swiss franc strength remain an issue (risen by 6.8% against the euro and 9.3% against the dollar in Q2). Swatch Group recently announced that it will struggle to meet its 2011 sales guidance of CHF 7bn if the franc remains at such high levels. Richemont said it was considering a 2nd price increase of the year for its brand Jaeger-LeCoultre to protect its margins against the franc.



Hong Kong remained the world's biggest market for Swiss watches, with exports up 29.3% (CHF 330.7mn) in June. U.S. remained the 2nd biggest market (up 9.7%), followed by China, which surged 79.1%.

Swatch Group mentioned in recent press articles that it may consider investing in a diamond mine due to the growing demand for timepieces studded with diamonds. "As the 5th biggest consumer of diamonds, a stake in a diamond mine would be interesting," according to the CEO Hayek. The company did not name any specific mines to be considered for a joint venture to secure rough supply.

## **USA**

### **Birks & Mayors**

For the full financial year 2011, Birks & Mayors saw sales increase by 6.2% compared to the previous year to \$270.9m. Overall same store sales increased 2%, whilst same store sales in the US increased 1% and 2% in Canada.

It also reported that sales increased 19% at the end of its first quarter sales for the 2012 financial year compared to the previous year. Same store sales were up 10%, with US store sales up 15% and Canada up 6%.

## **HONG KONG AND CHINA**

The retail business has entered a slow period since the end of June. The retail season will only pick-up again in September – October, with the trade starting to buy in August. Already now, the Shenzhen market is very active as jewellery manufacturers need to get their jewellery ready for the season.

Retailers as well have seen price inflation in both precious metal and diamonds. Very often this has cut into their gross profit whilst top-line numbers are up. Most retailers still report double digit growth on a like for like basis.

The fact that many of them have already, or prepare themselves to, appeal to public markets for funding is hardly a surprise. One needs much more money to run the same level of business, let alone finance the sometimes spectacular store expansion.

Overall sentiment continues to be one of optimism and also diamonds as a store of value gain in popularity. Many wealthy Chinese are looking for alternative investment vehicles now that the property market has cooled off.

## **INDIA**

The latest price rise of polished diamonds has made the retailers nervous, as pricing has become very challenging. Adding to their woes is the rising price of gold. Until now retailers had passed on the price rise to the consumer by hedging gold and diamonds to control their pricing. However retailers are now finding it hard to absorb the price change.

Majors in India believe that consumers will not be able to pay higher prices for VS – VVS quality goods, and are therefore expanding into weaker qualities. Pricing remains the most crucial factor on the export front also. The coming few months are going to be crucial for retailing, and the industry as whole. The consumers' reaction to price rises will matter a lot as Indian retail is entering its most important season.



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