

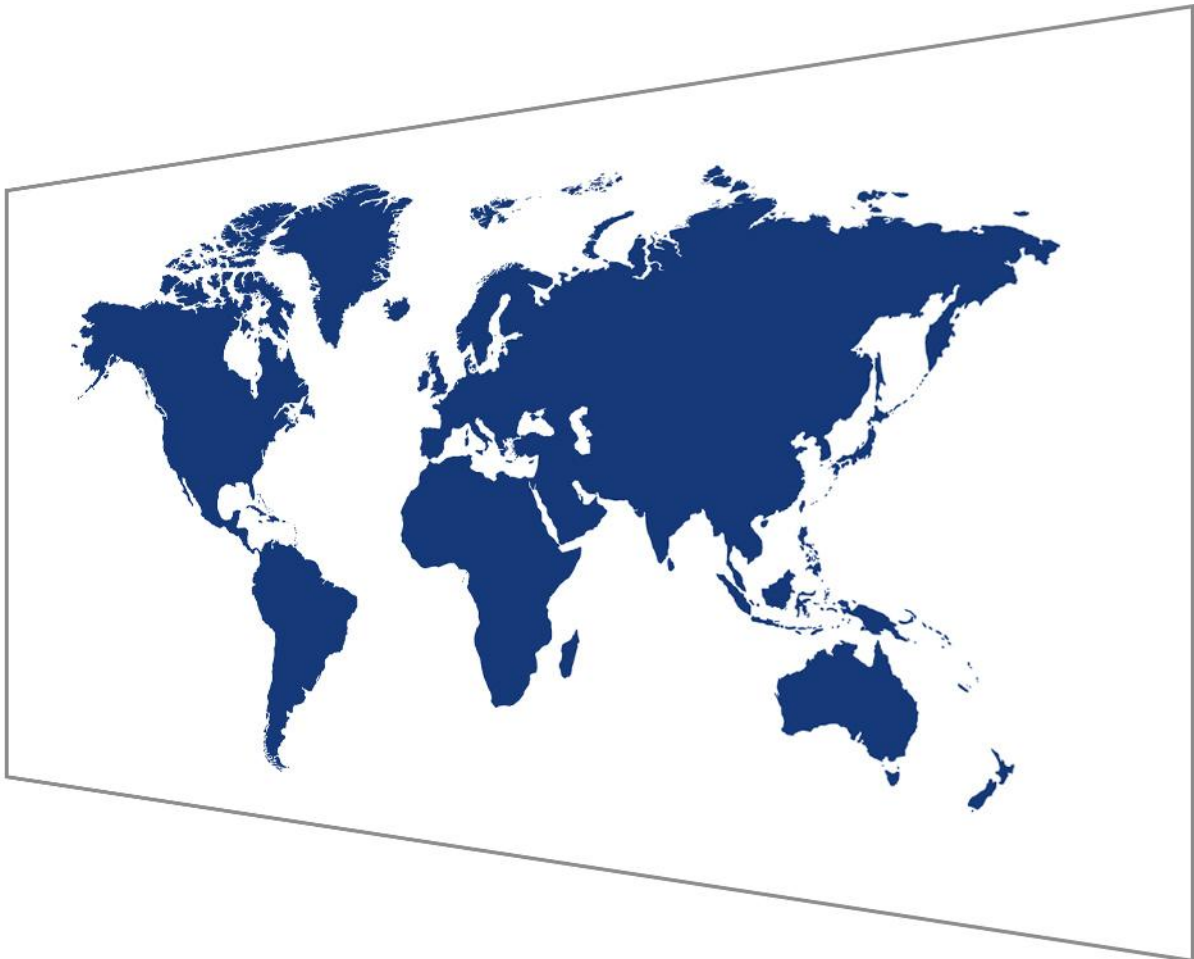


Bonas

Diamond Brokers & Consultants

Market Report

June 2010





Rough

It's been a long time coming, but the rough market has cooled noticeably in the last two or three weeks, and reactions to the June sight were much more measured than has been the norm. DTC prices were perceived to have risen by a few percent overall through adjustment to proportions and assortments. At the same time the Indian summer holidays and a seasonal softening of polished markets have had their effect on premiums. What's more, the perception in India is that quite a lot more rough, from Russian and other sources, is due to come in soon. That said, the overall trend in polished demand and prices is still upwards, so perhaps this is to be a two month lull in rough until later in August.

ANTWERP

It must be said that rough remains expensive and looking at our business, the detachment between rough and polished - as well as the disparity between our industry and the rest of the world is a concern. Much of current business has been about refilling the pipeline, and if the consumer doesn't participate, we will soon find that things have moved too quickly, too far.

At the DTC, sightholders felt that the price increase was balanced, but some items in the 4-8grs, 2.5-4cts and 5-14.8 have now become expensive. Often colours were found to be better, but models weaker. In general, manufacturing margins are under pressure. However, given the even more expensively priced rough on the market, premiums on DTC boxes were high again in the first two days of the sight. Things cooled down rapidly after that and in one week premiums have come down by 3-4%. Another issue is that credit terms are lengthening again: more and more people buy on 30-45-60 days rather than cash.

For BHP, the only way was up again this month and it was now the second time that BHP had had two separate spot market sales in two consecutive weeks; one for -2cts, and another for +2cts. It is assumed that this way they get better access to liquidity in the market and therefore this system will likely continue. On average the increase was a few percent and the volume sold approximately \$140m.


We estimate approximately \$60m worth of Angola comes onto the market every month, but this seems to be untouchable for dealers and considered very expensive. Little comes to Antwerp, as most is being traded from Tel Aviv or Dubai.

Russian goods are more expensive as well, but still seem to sell well: about \$250m per month. New contracts run until 2014 with price revisions possible every 3 months; an early exit is not foreseen in the contract.

Elections at AWDC this week have resulted in a landslide victory for Indian candidates who won all six Board Member seats representing diamond companies in three different categories of turnover. The other seats are reserved for representatives from the Bourses, the manufacturers association and one independent. In total 11 seats who will next week elect the new President of AWDC.

Mumbai

Most sightholders performed strongly at Las Vegas and came to the sight in an optimistic mood. Boxes were considered slightly more expensive as a result of lower colours and changes in size proportions. There was brisk trading in the early days of the sight but there is no doubt that the secondary market was significantly warier of overpaying than before. The most popular boxes, reflecting a general perception that pique goods may be in short supply, were the Preparers area (particularly Commons), as well as Spotted 2.5-4cts and 4-8grs. Cleaner goods were noticeably softer, for example Fine and Chips.



Demand in 3grs and below was reasonable, though the sharp increase in the Rejections area pushed them straight out of favour. Buyers of these goods switched to outside sources.

There is general feeling among manufacturers that polished is unlikely to rise by more than 2-3% in the next couple of months, meaning that, as far as they're concerned a rough ceiling has been reached. It is also quite noticeable that buyers of rough have started to ask for terms again.

The shortage of workers remains an acute problem in Surat. It seems most of the big units are working at about 60% of capacity.

Tel-Aviv

Premiums for many of the boxes have declined from low double digits last sight to high single digits this sight. Contributing factors are:

1. Price resistance from polished purchasers in the market and at the Las Vegas show
2. Upcoming summer holiday
3. Disappointment with the assortments of the some of the boxes

There is demand for most boxes on the second hand market but the demand is more considered and less hysterical. Some considered to be over-hyped are still floating on the market.

We expect premiums in July to remain similar to June's however they may well rise in August after the summer holiday / in time for the season.

Outside rough continues to be more expensive than first hand DTC goods and goods are in short supply. Pique goods are considered especially scarce/in demand. Fancy manufacturers are also having great difficulty in finding sources.

New York

The mood in New York and in fact in the diamond market in particular is very upbeat. The Las Vegas show met expectations and in some cases exceeded them, with optimism prevailing. Retailers across the US were ordering merchandise. There is much less talk of impending bankruptcies on the market. This, coupled with the increased appetite of India and China, makes for some very welcome good feelings across the market. The rough price increase went down with barely a murmur and though New York manufacturing is almost a thing of the past (with a few notable exceptions), some New Yorkers are getting into the act and are manufacturing rough overseas. Polished in an increasing number of ranges is almost impossible to source in the quantities people need, and prices are extremely firm in many areas.

South Africa

The sight was well received, despite the changes in prices. Clients are still confused as to how to apply the 80/20 principle regarding exportation of rough without attracting the 5% export duty. Coupled with this challenge is the requirement by the SADPMR that export permits must be renewed every six months, requiring a new police clearance be submitted every time. That will mean clients will forever be applying for police clearances, which is not practical, nor as per the new Diamond Act.

Botswana

Many sightholders are of the view that government is seriously pursuing the parallel trading option and it is no longer a matter of how but when this will be officially implemented. It still seems that the government of Botswana is not really clear what the objective of this will be, but rough price discovery seems to be the most frequent reason given. We also believe that momentum for establishing and effectively running diamond trading in Botswana will require the support of other producer countries. So far we have not heard of any firm commitments from any of the producer countries of South Africa, Namibia and now Zimbabwe, which all have local

issues to deal with. All in all clients feel threatened by these talks of trading, as there is still no clear communication as to their inclusion as priority clients, and the possible impact on their manufacturing investments so far.



Polished

ANTWERP

There is good polished movement in Antwerp and people are able to gradually increase prices in most areas. However it is not across the board and not following the same pace as the rough. On top of that, significant resistance is reported recently amongst polished buyers; they have put a halt to the situation as they are not able to pass on month after month price increases to their clients anymore. Clearly, jewellery manufacturers and retailers don't accept the upward price trend eating into their margin. A lot of polished traders fear that the current price inflation in rough is creating a new bubble as it is not supported by the right fundamentals in the market. The polished pipeline seems to be empty and inventory levels depleted, so buyers have no choice but to reorder again. But does this mean that the end consumer is buying as well? It is difficult to figure out but there is a strong feeling that current business activity is mainly driven on hope (and expansion plans) and that a refilling of the pipeline is happening.

TEL-AVIV

The Las Vegas show was generally considered positive: demand was good although not great, and profit margins were slim but at least they existed. A surprising amount of the business came from Indians. All in all, the show was in line with expectations.

The polished market is seasonally quiet compared with the first 4-5 months of the year. There is reasonable demand from all major markets however the buyers are selective and trying to resist the higher prices. Prices are relatively stable as they are held in balance by two opposing forces: a decline in demand vs. higher rough prices.

MUMBAI

The general sentiment in the market is still positive following a year-on-year increase of 73% in polished exports in May. New markets like Russia and Latin America have also opened up in the recent months. The pre-Vegas ebullience however has subsided.

Polished trading in India is now readjusting itself to the new requirements in USA, post the Las Vegas fair. Weaker qualities are moving well across all sizes, but there is a considerable slowdown in larger goods of better qualities as a result of the pipeline being filled, and retail being seasonally slow in both China and India.

In Seepz, those jewellery manufacturers with direct retail clients in the USA are doing well. They probably represent two thirds of the operations in Seepz and will be working at close to capacity. The other third, mainly contract factories, are feeling some pain and are probably only working at 60%. The same goes for any operations, in or out of Seepz, who work with the Japanese or European markets.



NEW YORK

Expectations before the show were fairly high. Overall, they were probably met although possibly not in the manner that had been anticipated. The most positive aspect was that polished prices were strongly defended and in some areas inched up. In areas where there are shortages prices are now as much as 15% above peak 2008 levels; however it should be stressed that there are ranges that are still 10% below their peak. People, though, were a little disappointed with the total volume sold.

US retailers were out buying but they are still concentrating on hitting their consumer price point. We heard that they are achieving this in one of two ways: either lowering qualities and colours, or increasing the quality but reducing the size. The reason for not lowering qualities further is that there is an increasing lack of pique goods around. That said, there was a noticeable increase in the number of buyers at the show from Asia and India.

In larger stones, 3cts+ were deemed weak, although we heard that well made, good quality 10cts stones are firmly back in demand and achieving peak 2008 prices.

HONG KONG

The early June Christie's auction in Hong Kong totalled \$60.41m, with many of its buyers hailing from Asia. The highlights of the sale included a single-strand jadeite bead necklace, which sold for US\$7.28 million. A heart-shaped fancy vivid blue 5.01-carat diamond was sold for US\$4.69 million while a pair of fancy deep blue heart-shaped diamonds of 2.48 carats and 2.03 carats suspending a pair of 10.12-carat and 9.64-carat pear-shaped diamonds sold for US\$4.4 million.

Next week the HKG June Jewellery Fair will start and this is considered to be one of the smaller shows of the year, with not a big number of participants and therefore expectations are modest. A large number of Israelis are planning to attend/exhibit.

The earlier measures taken by the Financial Secretary to protect the market from overheating seem to have had some effect with at least the housing market showing signs of cooling off. Retail in general is slow, but that could be seasonal.

Diamond traders report lots of price resistance and soft demand. Plus one carat sizes continue to move well, although they don't make up the bulk of the market.



Retail

EUROPE

Markets in Europe continue to be soft and the European customer lacks buying power. This situation is due to a combination of many markets being rocked by a debt crisis and dampening consumers' appetite for spending as a result; the traditionally low season; the soaring price of gold; and the weak €/€ exchange rate. There is confidence that demand will pick up from July/August onwards when people start preparing for the Christmas season.

Swiss brands are buying very well at the moment however their lack of flexibility remains an issue when trying to fulfill their narrow mm-requirements. The Federation of the Swiss Watch Industry reported exports rose 19.8% from January to March 2010 and 11.5% in April compared to the same month last year. For the watch industry, a weak € causes problems because the watchmakers are paid in Swiss francs (which has strengthened 6% against the € in the past 6

months). Some have raised prices to protect their margins. A stronger \$ is offsetting this for those brands who export into US and Asia.

Swiss watchmaker Hublot, part of luxury group LVMH, achieved record sales in the first five months of 2010 but is concerned that the European debt crisis will hit demand for expensive watches, the company said. Breguet, the watch brand from Swatch Group, is looking at a 50% sales growth in India for the current calendar year.

There is a strong feel that the slide in the € against major currencies should help many European luxury houses to attract more foreign shoppers. Their costs are typically in €'s, and their revenues are often split between US\$, Yen and Euros. The € weakness could boost their ability to be competitive outside Europe.

In Germany, business is steady and there is buying, however nothing great. Performance of independents is mixed. Feedback from Italy, UK and France ranges from soft to 'a little better'. Liquidity remains tight across Europe and payments often come in late.

Italian jewellery company Damiani accelerated its revenues markedly in the quarter ending March 2010, with an 18% increase driven by retail and wholesale. This is Damiani's first positive quarter since the beginning of the downturn. Retail continued to grow in April and May while wholesale trends remain contrasted, with signs of improvement in international markets offset by a more challenging domestic market (Italy is 77% of revenues).

USA

Signet Group's sales rose 6.2% year-on-year to \$810 million in its first fiscal quarter, ending May 1, 2010. Same-store sales increased 5.8% and net income rose 98 percent to \$52m.

Sales in the U.S. increased 6.8% to \$667.1 million and same-store sales increased 7.2%.

In dollar terms, U.K. sales rose 3.8% to \$142.9 million (£99 million), while same-store sales fell marginally to 0.2 percent.

Tiffany & Co. reported on sales during the three months ending April 30, 2010 increased by 22% on last year to \$633.6 million, while comparable-store sales were up 14% globally. Sales in the US increased 22%, Asia Pacific up 50% and Europe 25%. Japan was the only market not to grow.


Zale's revenue fell 5% to \$359.8 million during its 3rd quarter ending April 30, while same-store sales fell 2.2%. Compared to last year its net loss narrowed from \$19.5 million to \$12.1 million for the same period.

During May it negotiated a \$150 million loan from an investor, which allowed it to purchase a range of new products during the Las Vegas show, which it is hoped will revitalise its fortunes.

Birks & Mayors reported sales rose 29% on the same period last year to \$63.6 million during the fourth quarter that ended on March 27, 2010. Comparable store sales increased 18%, with U.S. sales up 19% and Canada up 17%.

Full year sales for Birks & Mayors' fell 6% to \$255.1 million, with like-for-like store sales also down 6%. On these terms, the U.S. fell 12%, while Canadian sales fell just 1 percent.

Harry Winston's Q1 saw it failing to break even, but losses were down from \$45.1m to \$8.7m year on year. Retail sales outperformed rough sales with revenue of \$65.1m up 25%.



Blue Nile Q1 sales at Blue Nile were \$74.1m with profits of \$15.8m, both numbers up year on year. The total revenue represents the highest Q1 sales the company has posted, up 18.7% on the previous years' quarter.

Chief executive Diane Irvine described the company as 'pleased' with the results.

HONG KONG AND CHINA

Chinese consumer loyalty to luxury brands remains high despite the economic downturn, according to a report released by KPMG. The report is based on a survey of consumers in 15 cities across China, which was conducted by market research group TNS in 3Q of 2009. Of the consumers surveyed, 72% said they felt little or no impact from the recession, while 62% said they would continue to maintain their luxury goods spending this year. The survey also found that self-reward and pampering are now top motivating factors for people purchasing premium products, as cited by 54% and 44%, respectively. The 927 luxury consumers surveyed were between the ages of 20 and 44.

Diamond jewellery sales have been good so far this year and the lead Chinese retailers report decent sell-through. In the last few weeks trading has become slow and usually this is a seasonal phenomenon that lasts until the end of August. The lunar festival this week, gives people an additional three day holiday and hopefully this will lure more customers to the shops. At the moment, vendors find it very difficult to push up prices and encounter a lot of resistance, also because there is much more competition now, which gives the retailer more options.

Interestingly, internet businesses such as z-bird and 9-diamonds have reported sharp drops in sales. These companies grew very fast in the last 9 months and for some this has caused growing pains at an organizational level. Also, it seems that not always the consumer has full trust and confidence in the way some of these companies operate.

The country's recent outbreak of social unrest has shown that on average, wages paid in our industry are significantly higher than wages paid in other industries

INDIA

With the onset of the monsoon, domestic retail has slowed down in all sectors. Jewellery too is moving much slower. Retail markets also have to deal with high gold prices and a weak rupee which is keeping buyers away.



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