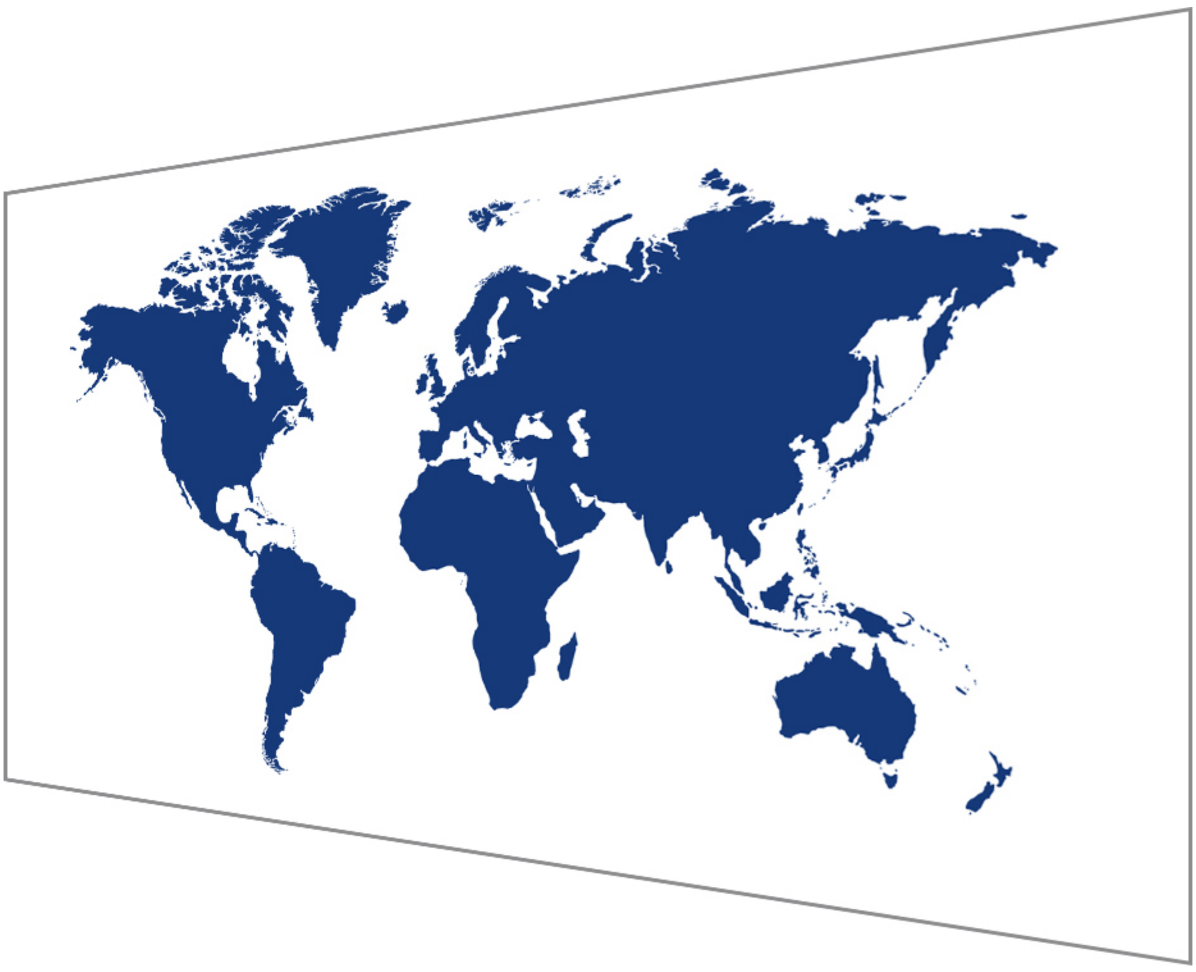
Market Report

May 2011



Rough

GENERAL COMMENT

Some of the froth has evaporated from the top of the market – mainly a seasonal lull down to Indian holidays, but there is an element of B2B resistance and fears of a bulge in the pipeline. Nonetheless, it remains a very firm market in most areas. Given the amount of diamonds projected to be available in the short-medium term, world diamond markets would seem to have few fears, though of course there are plenty of global economic spooks around if one's looking for impending trouble.

There is much speculation surrounding the outcome of the Botswana negotiations, particularly as sightholders turn to the business of applying for the new contract. How many new licences, when will aggregation happen, will there be a rough window etc?? Expectations for the Las Vegas show are good, though US demand shows a tendency to polarise to top and bottom. If a lot of foreign buyers turn up, that is expected to make it much better.

ANTWERP

The relentless price growth that we have seen in the rough market for the last 18 months, and which was particularly strong in the last 4 months, seems to have cooled off somewhat. The Easter holidays, Passover in April and now the holidays in India have reduced the level of activity.

First the spot market results at BHP showed a different trend with most prices stabilizing. Then there were the first DTC boxes starting to show negative premiums, mainly cheap goods. This is the area in which we have seen the most spectacular movements, but which people now consider overpriced.

BHP's sales in April were reportedly down 15% in carats and 17% in value. Prices of the +2.5ct better end goods were up, but down in other areas. In medium sizes prices remained stable as well as in -3grs, except for the Clivages which were down.

This pattern repeated itself somewhat in the DTC sight, here overall people were satisfied with the pricing of the 4-8grs and the +2.5 cts, but not with the pricing of the cheap Indian goods, hence the negative premiums. Sightholders buying small sawables were not very happy with the pricing of the -7.

The secondary market responded in line with that by immediately sending premiums on cheap goods into negative territory, whereas premiums in 4-8 grs and +2.5cts remained – on average – at between 8-12%. On Angolan goods, resistance is building and the feeling is that prices have peaked (for now), and are likely to soften a bit. Margins after manufacturing have become narrow.

In the first quarter of the year, probably just over $4bn worth of rough was sold by the producers. However, not everything ended up on the polishing wheels and some of the traded goods still needs to go through the manufacturing process. The resulting polished will be expensive and it will certainly be a further test for the price inelasticity' of our product. Indeed, retailers who have been confronted with continuously increasing prices, are resisting.

MUMBAI

Robust sales figures for the last few months, in both rough and polished, indicate that a lot of inventory was purchased in Q1, with strong demand. There was also some speculation that rough prices will keep increasing, and prices of polished will follow. However others say prices of polished stars and -2, having reached all-time highs, have plateaued.

In such a scenario, those stuck with boxes are feeling the pinch, as premiums have softened and even gone lower than list price, for example 1-3 Col Rejn. Certain March boxes in the Rejection band are still available but are not fetching the desired premium. Many felt that assortments were an issue in the 1-3 Col Rejn box, but the 7/5 component remains strong. MB 7/5 H and MB 5/3 too were considered to be weaker.

Meanwhile in manufacturing, activity will slow down, with factories operating at 60% levels as some workers go on holidays for the summer break, the pre-monsoon farming and for the marriage season. Not many units will close down entirely this summer though, as factory owners fear losing workers.

Other Indian Manufacturing Centres
Ahmedabad wants to increase production but a shortage of workers prevents them from expanding. As a result factory manufacturers are resorting to more and more automization. The only way to attract workers is increasing labour rates, which still have to catch up with those of Surat.

TEL-AVIV

Rough prices rose in the first three to four months of 2011 at a pace many believe to be unprecedented. Prices have cooled a bit over the last month and are now stable. Indian summer vacation and Israeli holidays contributed further to a more relaxed feeling in the market.

Premiums on 2nd hand boxes remained more or less the same, with a weakening of 1% to 2% in 5+cts. There are very few 4-8gr boxes on the market, leading to high premiums in this range.

BHP and Russian prices have also remained more or the less the same. Angolan prices have corrected themselves; however this is only due to prices having shot up too much, too fast and they are now at a more rational level. Supply of non-DTC to the market has not increased and rough is considered scarce.

Speculation in rough prices is not apparent.

The barometers for the market looking forward appear to be:

- The Las Vegas show
- Indian manufacturers' appetite for rough after the summer holiday

NEW YORK

There is a lot of talk about a few rough players looking to purchase boxes of anything from any original source, regardless of how it compares to market value, and paying a premium for those goods. They are openly saying they are buying to put in their safes. For normal manufacturers rough is certainly considered to be overpriced in many areas. There is some belief that premiums may just be beginning to plateau.

SOUTHERN AFRICA

In Botswana the rumour mill rumbles on as we wait to hear about the new contract.

Many sightholders were quite short of goods by the time the sight arrived – higher prices, less carats – so were knocking on the door eagerly. Some seem to have banked earlier on increased supplies/caratage and, having taken on more workers in view of good polished demand, have been left scratching around for stones.

The public services strike seems to have had little impact on our business.

Shortage of goods continues to be the major worry in South Africa, and the impending handover of Finsch will do nothing to enhance the mood.

Polished

ANTWERP

Polished is moving well however there is a collective concern over buyers' price resistance at the moment. All hopes are set on the upcoming Vegas show to establish a new price level. Buyers order smaller volumes and are unwilling to stock up goods due to a continuing liquidity drought. Exceptions to all this are the watch manufacturers who continue to fulfil their needs with little price resistance.

A supply vacuum is reported in small clean goods and some pointer areas. Strong price resistance has been reported by French and Italian diamond jewellery manufacturers.

- +3cts: Strong demand. Prices up by 4-5% since last month.
- 0.20 – 0.90 ct: Shortage in better end goods mainly due to less manufacturing over the last months. Focus of demand is the Far East. Limited resistance to prices accept prices which are up by 3-5% since last month. Colours also doing well too. Piqué pointers are very strong (such as piqué 30, 50, 70pts). Dossier pointers: Goods are moving at a brisk pace. Some believe there is even a supply vacuum; others report there are plentiful goods in India.

TEL-AVIV

The polished market has achieved a degree of stability, which is good news to all who were concerned the bubble will pop and a major correction is likely. So far it appears the bull market in 2011 'has legs'. Demand continues to be steady and prices have stabilized.

Demand from Hong Kong/China traditionally cools down a few months after CNY however there is little evidence of this. As a result of excellent retail sales, stocks are low, demand continues to be strong and sourcing material for this market is a challenge.

Demand from the USA is pretty good: companies with good distribution into this market are doing well. Many are cautiously optimistic this is a harbinger of a successful Las Vegas show.

- +3cts: Steady demand in this area, of 3 and 5 ct sizes, which are moving relatively well, 4cts is slow.
- 1-2cts: 4-6 grs is still the fastest moving size. 2cts also moving fairly well.
- Fancies: Princess moving well to the USA especially I1 clarity. 4 grs generally moves well however 3grs right now very hot. Emerald cuts have cooled down a bit since last month however are still sellable. Cushions also continue to move well. Stable sales of round-edge fancies from 6pc to 3cts. Strong demand for pear shapes in VS+ clarity, good colour.

MUMBAI

Polished trade has been doing well, although quieter now due to holidays. Stars and -2 continue to perform the best due to shortage. Prices have been stagnant for a couple of weeks. K colour stones in the smaller sizes have been in very good demand; In the larger sizes, +70pts and 1cts have been performing very well, with 30-50pts lagging a bit. Polished stocks building up.

- 1ct: Performing very well in triple ex goods in SI up
- 0.70+ ct: Strong across the board but SI2 above has appreciated by 4%
- +6.5/-6.5: Selling at same rates as -6.5 and prices have softened by 3% compared to last month.

NEW YORK

At macro-economic level, the US economy still appears to be gently rebounding, with unemployment registering another fall this month and the economy seeing some growth. However, sales to US retailers have seen a distinct cooling off in the last couple of weeks. Most believe this is entirely seasonal and only to be expected pre-Vegas.

Sales to overseas however continue to be strong, and this is where companies are able to push up their polished prices in the areas outlined above.
This, coupled with the continuing boom in rough prices, means that there is no likelihood of any softening for the foreseeable future.

Mother's Day was described by the trade as fair-to-middling. Sales of $99 diamond pieces using sterling silver was where most of the action was seen for Mother's Day. Sales to the end consumer are increasingly split between the cheap end e.g. <$200 and the high end >$3000. Indeed the market is reporting that one or two retailers are now making a concerted effort to stock items catering to both of these markets, and reducing items traditionally sold to middle America.

Concentration is turning to Las Vegas at the end of the month. Opinions are divided as to the outcome of the show, with a number of people stating that much will depend on overseas buyers. There is not expected to be huge demand from American retailers.

- +5cts: Prices have certainly stabilised in this range. Demand is marginally weaker than last month. Items moving remain the very well made goods.
- +2cts: 2 and 3cts are selling very well. D-J colours, VS-SI in triple excellent aremoving at a pace. There is not much supply in these ranges. Triple very good are also moving well. Interestingly VVS goods are now cheaper than VS goods. VS goods are selling very close to list price. 2cts in the demanded ranges are selling at 5% more than last month.

HONG KONG

Polished trading business has been very good in Hong Kong in the first four months of the year. A lot of traders were able to move goods and clear their inventories ahead of the important sales week of May 1st. That seems to have gone well and the expectation is that business will slow down a bit from now on to then pick up again mid July ahead of the wedding season.

Both the Diamdel and the Alrosa auctions in Hong Kong are drawing a lot of interest this week. Especially the Diamdel goods are geared towards the Chinese manufacturers, whereas Alrosa sell quite a lot of Indian goods which attracts several Indian buyers.

The Hunan manufacturers have had some difficulty following the rough market's high prices. They typically concentrate on rough of 2.5ct and up, on which they did very well in 2009, but on which they are struggling at the moment.

- 1+ct: Good demand still in 1.00-1.50ct., especially Si. Prices are firm.
- 0.70+ct: 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%.

Retail

EUROPE

"Luxury shame is over": The outlook for the luxury goods market has improved significantly in recent months, boosted by a stronger-than-expected rebound in the US and Europe and surging demand in China, according to Bain & Co consultancy firm. Strong tourist flows in Europe coupled with a pick-up in sales at US department stores contributed to the recovery. Bain raised its 2011 growth forecast for luxury sales to 8% (€185bn). China, set to become the biggest luxury goods consumer within 5 years, will be the top contributor to this growth. Luxury sales in China rose 30% in 2010 and are forecasted to grow 25% this year (to €11.5bn), while U.S. luxury sales are set to grow 8% to €52bn in 2011 after rising 10% in 2010 to €48.1bn. Japan is expected to see luxury sales fall 5% this year (€17bn). Some favour Brazil over India as the next big source of growth after China, as India's lack of retail space and preference for traditional dress and home-made jewellery makes it tough for European brands to penetrate. Brazil's luxury sales totalled €1.8bn in 2010 and are set to grow 10-15% between 2010 and 2013, Bain estimated. In Russia, Bain sees sales growing 5-10% by 2013 (€4.8bn in 2010). The Middle Eastern market (worth €4.1bn) is likely to grow 10-12% over the same time span. In 2009, the worst year on record for the industry, global luxury sales fell 8%.

Rolex replaced its CEO after only two years, raising questions about possible management problems (some think internal differences of opinion on the degree of openness to the outside world). Riccardo Marini, who was previously responsible for Rolex Italia, will succeed Bruno Meier. Rolex sales 2010 are estimated at CHF 4.4bn ($5.1bn).

According to a new report by Global Industry Analysts, global watches market will reach $46.65bn by 2017. The watch industry witnessed the steepest decline in 2009 in terms of exports and revenue generation. Europe remains the largest regional market for watches. Asia-Pacific remains the fastest growing regional market, with sales of watches increasing at CAGR of 3.6% and 4.2% respectively over the analysis period. By product, Luxury watches remain the largest segment in the global watches market. Mass-priced watches represent the fastest growing watches segment, growing at a CAGR of about 2.6%.

Hermes' overall first quarter sales went up by 25.5%. The group, enjoying a rebound in the US and strong demand in France and Asia, benefited from solid appetite for discreet and conservative luxury items and said April trends were in line with the first quarter. The company kept the 2011 sales growth target at 8-10%. Sales hit €637m ($890 million). Watch sales rose 34%. The operating margin, which reached 27.8% for 2010, could drop slightly this year. Hermes' European sales rose 21%, while sales in USA soared 33%. Asia, excluding Japan, rose 27%.

USA

Blue Nile

Overall Q1 sales were reported to be $80.2m, an increase of 8.3% on the previous year. In the US sales rose 4.3% to $67.3m, whilst sales overseas were $12.9m, an increase of 34%.

Michael Hill (New Zealand)

Sales in the company's 9 US stores fell 25% to $6.0m (in local currency) during the first 3 quarters of its financial year. However, as company closed 8 stores in the last year, same store sales increased 19% (in local currency). The business in Canada reported sales of $27.3m, an increase of 27.3% for the same period (in local currency).Same store sales were up 12.6%.

In its core market, Australia, sales were $194m an increase of 5.7% (in local currency) with same store sales up 4.8%. New Zealand sales increased 4.7m% to $77.6m, with same store sales up 3.5%.

HONG KONG AND CHINA

China's consumption of diamond jewellery continues to thrive on store network expansion and consumer spending. Although it is early to get full feedback on the all important sales week of May the 1st, initial reports from retailers are positive. Many report increased sales compared to last year, some up 25-30%. This year the bigger sizes are stronger and gaining market share. As we know, this is often in combination with lower purities and/or colour.

Annual consumer inflation in April was officially 5.3% and while Beijing is reducing the availability of credit in the economy, mostly through direct orders to Chinese banks to slow lending, the government is wary of dampening growth too much, as many believe it did in the early part of 2008 when inflation spiked above 8 per cent.

For one thing, Beijing is encouraging double-digit wage increases – of up to 40 per cent a year in some places – as a way of reducing the country's wealth gap and shifting the country away from over-reliance on cheap, labour–intensive manufacturing industries.

INDIA

April and May are synonymous with summer holidays in India, and therefore a slow market for retailers.

Price volatility for gold and silver has not influenced the market as much as diamond prices. Though sales have gone up value-wise, due to the increasing diamond prices, volumes have remained fairly constant. Akshay-tritya had tremendous sales as gold bullion prices took a dip on that day.

Export of diamond jewellery has been good and orders are healthy, though increasing polished prices is putting a lot of pressure on the manufacturers, especially as the retailers in US and Europe have been showing signs of apprehension at growing diamond prices. All eyes are on the Las Vegas Show as jewellery manufacturers are hoping for a positive show.

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