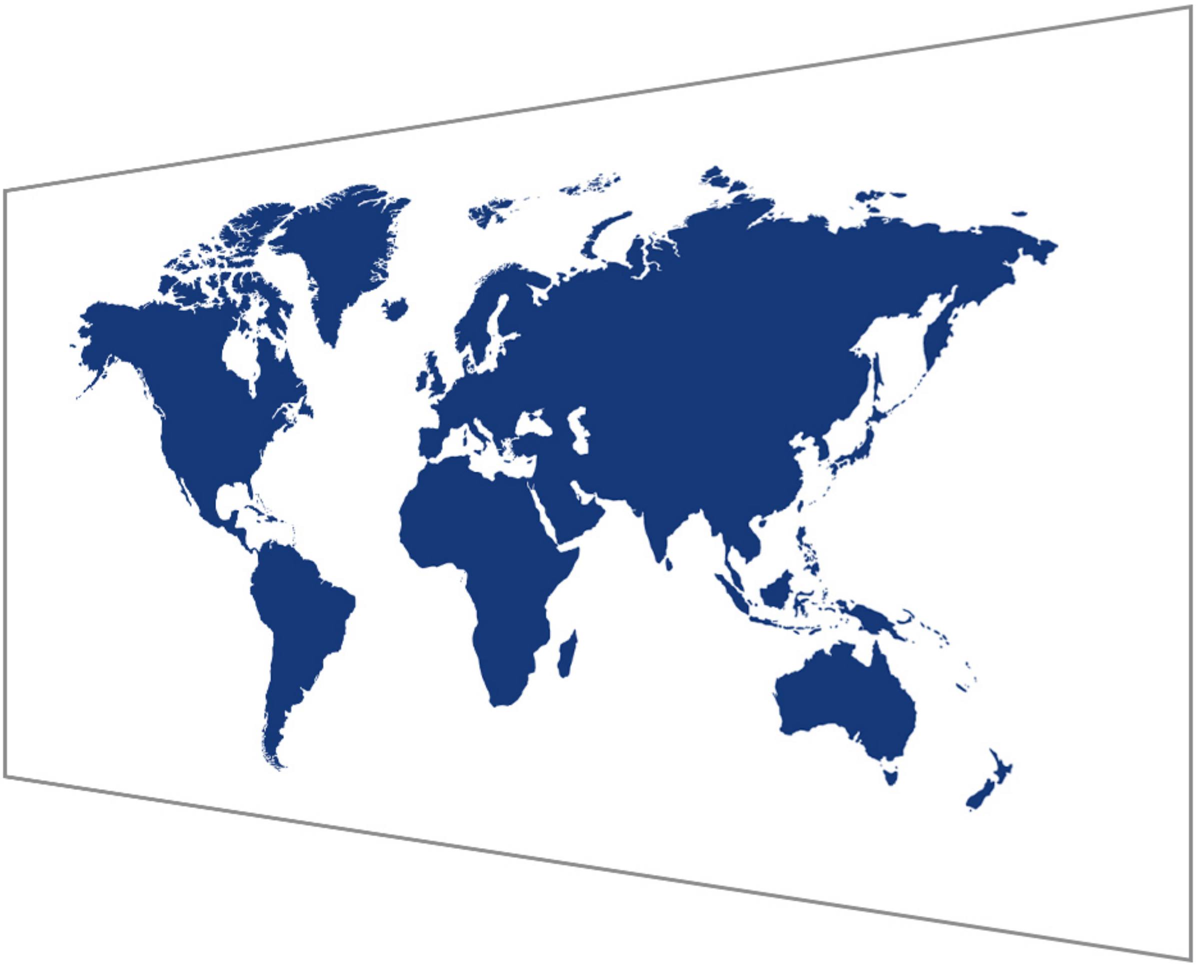
Bonas

Diamond Brokers & Consultants

Market Report

October 2011



Rough

GENERAL COMMENT

The overall trend is downward, though being in the midst of the season means there are also contradictory cross-currents. The Hong Kong show was a bit better than expected for some people, particularly given the huge volume of goods shipped out there and on offer. Those who were more flexible on price were able to sell adequate volumes.

Over the last few months the rough market has plummeted, even though polished demand is not bad, and in a few areas is good. The pipeline could use some purging – either through reduced volume of rough to the market or increased polished demand, or both – if the market is to be back in shape for the new year.

Sightholders are relieved the contract in Botswana is finally signed, but also a growing realisation that a huge amount of works needs to be done on logistics and infrastructure so that the country can live up to its aspiration to be a major global diamond hub.

ANTWERP

The rough market has continued to slide since July. Appetite for rough continues to dwindle for a host of reasons: not enough liquidity, quantities of rough from earlier in the year still waiting to be manufactured, Diwali holidays coming up, and a slowdown in polished sales. Negative global economic sentiment is an additional external factor determining the mood.

DTC Sightholders have been struggling with manufacturing margins on most of the DTC boxes since July, and the rough to polished gap has widened since then. In this environment, manufacturers try to synchronise the content of the boxes as close as possible to their polished distribution requirements which explains why a number of clients have made use of DTC's offer to buy back parts of boxes. Polished prices have dropped most in 6grs up which is why large goods are found the most challenging.

Quotes on DTC boxes are negative across the board, with most of them lower than List -12%. However, we don't believe a lot of transactions are actually taking place and those who have the infrastructure prefer to put it into manufacturing and postpone the problem to a later date.

Market sentiment is also reflected in tender results at BHP, as shown by the second drop in a row of their prices achieved. Results from the latest sales tender were reportedly down 12% in value and 13% in carats. The term contracts were re-auctioned for a period of two years. On average people were reportedly prepared to pay a 1.5% premium for this certainty of supply, as opposed to 3% last time round.

Angola rough has reportedly dropped 30-35% from the peak but very little is around.

With twelve sales a year, and at current prices, Alrosa takes up quite a bit of liquidity from the market. Traders now reportedly suffer substantial losses of between 15-20% and few people were prepared to take the additional goods presented to them this month. We hear that Alrosa intends to sell less in the months to come.

MUMBAI / SURAT

While the fundamentals of the Indian market remain satisfactory, the mood is very cautious. The change was triggered by two months of subdued B2B performance in polished and a slow-down in rough trading, resulting in large inventories being built up.

Larger manufacturing units are working at full capacity in the build-up to the Diwali holidays, following which we anticipate a lull for two or three months. Some manufacturers-wholesalers feel polished will pick up and are holding, while some are taking a measured loss on polished inventory, as well as depleting rough stock, which will allow them to enter the new cycle of corrected prices more quickly.

~20% of smaller players (those with 10-15 wheels) have closed down because they cannot survive manufacturing high-priced rough and selling it as discounted polished.

So far no significant distress sales in rough have been reported, but there is fear of some smaller players going bankrupt. Negative global news, a weak rupee and the declining Indian stock market are not helping sentiments.

Most DTC boxes are being quoted at 2 to 25% below list, but few trades have actually happened.

Other Indian Manufacturing Centres

Contractors of larger Sightholders are operating selected factories in Ahmedabad and Bhavnagar, and over 15% of the units were given an early Diwali break. Of the factories still operational, many will close a week early, with no guarantee as to when business will resume. Those still operational are focusing on quality makes.

TEL-AVIV

Very few boxes were traded last week and this is not expected to change before next sight. Indians are not buying either - regardless of price - and so the indicator in rough went back to being compared with polished prices and not to premiums on the market.

Manufacturers today state that in order to produce original goods profitably (from any 1st hand source), prices need to be lower by 10-20%, depending on the type of rough.

Some argue that producer's lowering prices now would hurt stock values and make 2011 a less profitable year than 2010; others argue that stock prices (and Rapaport's list) have already dropped (and continue to do so) and suppliers must adjust the prices of rough to the market prices, so that new production will be priced realistically.

SOUTHERN AFRICA

The broad details of the De Beers and Government of Botswana (GRB) Agreement were finally announced following a nine month delay of negotiations. DTC has secured a 10 year purchase agreement with Debswana – moving away from the usual 5 year agreement. Aggregation and sales activities currently carried out in London will relocate to Gaborone by the end of 2013. All DTC sights conducted in London to international Sightholders will be carried out through a Botswana based subsidiary of DTC.

DTC Botswana sights will continue as is, but with planned sales of around US$800m a year. Furthermore, GRB have the right to purchase 10% (increasing to 15% over the next 5 years) of Debswana's run-of-mine production for GRB's own managed window sales, giving GRB direct access to the diamond market. GRB are yet to publicise details of their windows sale mechanism and participating criteria. The purpose of GRB's window is to expand Botswana's diamond related activities beyond manufacturing and into tendering and trading and to attract international dealers to Botswana to participate in what would be significant additional supply outside of DTC's channels.

Polished

ANTWERP

Most Antwerp companies returned from the HK fair with meager sales results and shrinking confidence. The majority of the buyers were waiting on the sidelines unless they could buy at large discounts.

At reduced price levels, there is polished demand in Antwerp. However large price differentials exist amongst suppliers today, depending on the seller's necessity to raise cash. It feels like there is always someone cheaper and this does not instill confidence in buyers and, combined with a general liquidity shortage, has resulted in customers ordering small and selective amounts of goods.
Good demand is reported in SI-piqué quality 4gr up where prices have been adjusted by single digit percentage compared to last month. Price adjustments have been reported in 10/p ct down. In better end smalls, activity is expected to be sustained until next quarter.

TEL-AVIV

The polished market is subdued and the direction of the market is unclear. The internal market trading between polished dealers has almost dried up with the real business being done by manufacturers with good relationships abroad. Buyers from the USA have been buying for the season. There is demand from Asia but many retailers are sitting on the fence waiting to see if Rapaport will lower prices. In China retailers are stocking for Golden Week and the engagement/wedding season.

Reports from Israelis who exhibited at the Hong Kong show vary from bad to better than expected. Players in large stones had an abysmal show but the 'bread and butter' goods could be sold after dropping prices, with the exception of popular items which remained stable.

3+ cts is the weakest area of the market with prices dropping dramatically over the last two months. Economic uncertainty appears to be primary culprit. Reasonable demand for polished under 2 cts in round, princess and cushion: SI2-I2 clarity.

MUMBAI

Indian polished trading at a B2B level is at a snail's crawl, with many focusing on depleting inflated inventories. There are some small businesses in the certified and dossier areas that have been bought as well. Overall though, there is little demand.

Sales of 1+ carat is depressed, especially in VS+ clarity where prices are down an additional 10-15% over last month. +11 is also a very problematic size while -6.5 is better although hardly stellar. Pear, marquise and princess shapes are selling well, mainly through programmes.

NEW YORK

The industry has not escaped the effects of the global economic turmoil over the last couple of months. Rough, on the whole, is considered over-priced and people are losing significant capital whether they are manufacturing or trading; polished prices have dropped, on average, 15-20% from their peak; liquidity is tightening considerably.

Normally at this time of the year, people are starting to see orders for the season. This year they have yet to pick up, however, this is explained primarily by the uncertainty of pricing. Retailers are likely to leave it as late as possible to order stock in the expectation of further falls in polished prices in the coming weeks.

Sales of 5+ cts has almost come to a standstill with large gaps between seller’s asking prices and buyer’s offers. Sales of carat size rounds G-I colour, VS2-SI2 are still relatively strong however prices are down 5-15%.

HONG KONG

The Hong Kong September trade fair didn't cause the havoc people feared. According to insurance companies, new records were broken for both overall volume and also individual volumes shipped by certain companies. Foot traffic was less, and in general participants found it quieter than usual. Those who sold a lot were also those prepared to discount prices more, and the ones that didn't discount so much took most of the goods back home; in both cases, a deliberate decision. The non-Indian companies were stronger on prices.

In the aftermath of the show, the Hong Kong polished trading market has gone unusually quiet. Demand for polished has slowed down in all sizes and there is a lot of confusion about prices. Also, price differentials between companies sometimes mount to 20% for the same goods. The -11 area is still the best performing area, and price discounts increase with the growing size, with 2 and 3ct diamonds down 20% from their peak.

The 5 October auction of Magnificent Jewels and Jadeite accumulated a total of US$65 million (estimate: US$86–110 million), the highest total for a sale of Magnificent Jewels and Jadeite at Sotheby's in Hong Kong.

The sale set World Auction Records for these two important coloured diamonds:
- Mandarin Orange - A 4.19-Carat Fancy Vivid Orange Diamond and Diamond Ring sold for US$2.9 million. This was a World Record price of US$705,587 per carat) and the highest price for any fancy vivid orange diamond at auction.
- A 6.01-Carat Fancy Vivid Blue Diamond and Pink Diamond Ring sold for US$10 million. This was a World Record price per carat for any fancy vivid blue diamond of US$1,686,505 per carat.

Retail

EUROPE

The European diamond jewellery retail market remains fragile and the lack of market stability is affecting jewellery orders. There is limited stocking across the markets and emphasis is strictly on what sells. Suppliers try to collect orders by creating products, which fit the required price points, and at the same time have maximum perceived value. Demand is mainly driven by classic solitaire and bridal pieces.

Feedback on retail sales in Europe ranges from ‘practically dead’ (Italy) to ‘very weak’ (UK) and ‘okay’ (Germany). Those who benefit from tourist traffic tend to do better than others. It is difficult to collect money nowadays; many are paying late and waiting for someone else to pay first.

Swiss watch exports were up 16.4% in August, reflecting respectable growth considering challenging comparison basis (up 26% in August 2010). Average YTD growth until August 2011 stood at 19.2%. Analysts expect 11% growth for the last 4 months of 2011. Watches wholesaling between CHF 500-3000 posted the strongest performance (up by more than 30% both in value and volume). Watches of CHF 3000+ recorded the smallest increase at around 10%. Asia remains strong with Hong Kong up 18.4% and China up 44.3%. USA increased by 21.8%. Europe was more mixed with Italy recording a surprising growth at 43.8% and France the main negative down -6.1%. Japan posted a 5.7% increase in August.

The Swatch Group has ended its partnership with Tiffany & Co., accusing the jewellery maker of failing to comply with the terms of their contract. The two companies entered into an agreement in 2008, establishing Tiffany Watch Co., which was a wholly-owned by Swatch. This venture was responsible for development, production and distribution of Tiffany & Co. branded watches.

USA

Signet Jewellers is already revealing positive results, saying that same store sales in the first eight weeks of the third quarter are up nearly 10 percent.

HONG KONG AND CHINA

The first week of October is an important week for retail sales in China when people have a one week holiday for the Moon Festival, also called Golden Week. Important also because the Chinese government tries hard to stimulate consumer spending to keep the economy going, as exports drop.

Overall, retailers are happy with their performance so far this year as like-for-like sales have grown by solid double digit figures. Store expansion has been an important driver as well, with perhaps 3,000 new stores opening this year. But ultimately, consumer sell-through is the most important consideration.

A lot of retailers performed really well in 2011 thanks to surging gold sales and gold prices. Traditionally, retailers turn this product approximately three times faster compared to diamond jewellery. Therefore it would be wise to analyse top-line sales according to product mix.

Fears of an economic slowdown in China have fuelled a trading surge in Chinese Credit Default Swaps. While Chinese sovereign debt is still considered as among the safest in the world, the price of China CDS hit a two year high this week.

INDIA

September was a very slow month for Indian jewellery manufacturers and retailers alike. With gold prices see-sawing and economic concerns growing, customers are holding back on gold purchase decisions or buying only what is absolutely necessary. Our estimate is that month-on-month September was down 10-15%. Retailers are hoping for sales to pick up a little in the run-up to Diwali.

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