Special Edition

Answers to 8 Key Questions On Future of Global Diamond Industry

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Diamond Shades

Point of View

Dear Client,

Perhaps you have noticed the recent trend of a growing number of companies releasing their own proprietary reports on the global diamond industry, including ours.

I think people are searching for the most realistic analysis of the future of the diamond industry and are not completely satisfied with the analysis that is out there.

For one thing, many investors now want to invest some of their hard-earned money in diamonds. The idea of diamonds as an investment is definitely a growing, although hazardous, global trend.

As you know, the key to any good investment relationship is clarity - the ability to see, and even be in communication with what is really going on. It is the same whether it is a company, an industry or a country.

Since you have on-going interest in the diamond industry, I'm positive you would like to understand what goes on with it.

That is why, for three years non-stop, we have worked hard and devoted a lot of our time and energy in our goal to demystify and unlock the diamond industry. Not only did we do it for ourselves, we also did it for all investors worldwide.

With this is mind, three reports on the global diamond industry were released in August and September 2014. **The Global Diamond Business 2014** report by Equity Communications in August, followed in September by **Perspectives on the Diamond Industry** by Mckinsey and Company and **The Diamond Insight Report 2014** by De Beers.

All three companies sought to present their views on the likely direction of the global diamond industry in the coming years. You will have to read each report to find out the different point of views out there.

However, as Head of Diamond Industry Research at Equity Communications, I looked at both the De Beers and McKinsey reports to note differences and similarities in our viewpoints.

I believe we have a duty to clarify our point of view in instances where it differs substantially from the point of view of established industry experts. After all, you pay to access insight and analysis that is provided elsewhere free by the prestigious experts.

Equity Communications only started looking at the global diamond industry in 2011 at the request of opportunists who wanted to find out how they could benefit from the discovery of huge deposits of diamonds in troubled Zimbabwe. Therefore, at face value, it is a no-brainer whose opinion matters most.

To be sure, it is usually a good idea to defer to the opinion of experts on many subjects that challenge us in life. You have to respect the opinion of people who spend hours upon hours improving and perfecting their craft...it's just commonsense.

But after having read lots of literature on the diamond industry by its leaders, I can tell you that they are not immune to mistakes and miscalculations.

I'll be honest with you; I was initially troubled when I first heard De Beers had released their own report on the Global Diamond Industry. If you want expert opinion on the diamond industry, why look elsewhere if De Beers provides it for free?

Nevertheless, after the initial selfish disappointment, I eventually looked at the whole thing objectively and soon realised that at least my research team could now test its analysis and insight against the ultimate diamond industry expert.

Now I'm grateful that De Beers made public their storied expert views on the global diamond industry. Most of all, I appreciate their research findings on the key diamond consumer markets of USA and China. The research findings immediately strengthen our analyses of the USA and China jewellery markets.

Of course, I'm also going to challenge De Beers on some of their insight and analysis. But only on issues that we differ strongly. As an aside, once you look at the three reports, you soon realise we have similar viewpoints on many topics that affect the diamond industry.

De Beers' Diamond Insight Report provides valuable information and analysis of the global diamond industry.

But let's not forget that the report is also meant to drive forward De Beers' interests in the diamond industry. I believe some of these interests are aligned with the interests of the wider diamond industry. But there are others interests that are self-serving and may actually be at odds with the interests of the wider diamond industry.

In its insight report, De Beers states that relentless diamond industry focus on two main areas will help the industry achieve its full growth potential over the coming years:

- The first is safeguarding and nurturing the diamond dream - that is, the allure that diamonds have for consumers, based on their association with romance and a sense of the eternal, and the fact that they are seen as a lasting source of value. As always, changing consumer preferences, competition from other luxury categories, and - among other risks - the potential confusion caused by undisclosed synthetics all pose challenges for the entire industry.

- The second is for companies across the whole value chain to innovate and differentiate, to take full advantage of opportunities created by the expected growth in demand.

To achieve the above, De Beers identified three areas of investment that it believes are of key importance:

1. Investment in branding, marketing and raised retail standards will help ensure that consumers, particularly among new generations and new markets, do not drift away from the diamond jewellery category in favour of competing categories, such as travel, coloured stones, electronic accessories or designer fashion.

2. Investment in production to drive innovation and productivity in diamond supply. Diamonds have always been a rare and precious resource, and as mining moves deeper into the earth and towards more remote locations, the extraction process is now becoming increasingly complex, remote and more costly.

3. Investment in technology will continue to be a key differentiator across the value chain, while also safeguarding consumers against the risk of undisclosed treatments and synthetics, which could undermine the long-term credibility of the industry.

Lack of investment in these areas could hamper growth for the industry as a whole.

With this in mind, I don't have any reservations about number 2 since it's straightforward and absolutely crucial for the future of the global diamond industry and certain producer countries in Africa.

On the other hand, number 1 and number 3 deserve more scrutiny...particularly in the context of what De Beers is doing in these areas. So join me as I take a closer look at De Beers in this special Point of View edition.

As usual, I hope my viewpoints will be useful in your business endeavours.

Sincerely,

Tinashe Takafuma

Tinashe Takafuma

Head of Diamond Industry Research

Important Message

In this issue:

Answers to eight questions on the future of the diamond industry

As the diamond industry evolves to respond to recent consumer trends and macro-economic realities, there are new – and sometimes surprising – answers to perennial questions. What is the outlook for diamonds? What are the trends to watch? What do those involved in the industry – from exploration to retail – need to do to ensure continued and sustainable success?

De Beers, as the world's leading diamond company, has provided answers to these questions. I scrutinize some of these answers and show you where you might need to look for a different viewpoint.

- Diamond Brands Future of Retail Trade of Diamonds?
- Consolidation to Get Rid of Industry Dead-Weight?
- De Beers Using Forevermark to Reclaim Control of Diamond Industry Pipeline?
- Lab-Created Diamonds a Form of Terrorism on Diamond Trade?
- De Beers' Data on Global Diamond Production and Sales Questionable?
- Diamond Demand to Outpace Supply?
- Are We Running Out of Diamonds?
- Polished Diamond Prices to Increase Faster in Future?

Please note: Text highlighted in blue is from De Beers' **Diamond Insight Report**. You can download it here:

http://insightreport.debeersgroup.com/

Other reference material is from the **Global Diamond Business 2014** report by Equity Communications. I assume you have a copy. If you do not have, you can download it here:

http://www.diamondshades.com/diamondreport/get-your-copy/

1. Diamond Brands Future Of Retail Trade Of Diamonds?

Diamond Brands Future of Retail Trade of Diamonds?

Are you familiar with Hans Christian Andersen's **'The Emperor's New Clothes'**?

Well, I am that boy who shouted, "But the Emperor has no clothes!"

The story is appropriate for what I am going to do in this note. Someone has to take a critical look at De Beers' new marketing ideas for the diamond industry because, frankly, how many people in the industry are going to do that?

I understand the reason for this but I am not here to curry favour with the big players in the diamond industry.

So I am going to be straightforward about how I see things even if that means stepping on the toes of the influential and untouchable. Industry fortunes are at stake here.

By now, it is clear that De Beers is passionate about the promise of diamond brands. Diamond brands are believed to offer the best path to long-term growth of the diamond industry.

Furthermore, De Beers believes diamond brands allow for the transfer of higher rough diamond prices to consumers. The argument is that the market should not ask diamond producers to quote lower prices for rough diamonds. Rather, the market must innovate with brands and shift these higher prices to consumers.

However, the idea is not working out in the wider industry context.

Still, De Beers will keep pushing.

The way I see it, De Beers is probably envious of the margin success achieved by many luxury brands in the retail place. Therefore, the company wants to see some of that success being replicated in diamond retailing.

Unfortunately, if we take into account the dismal financial performance of De Beers Diamond Jewellers, some things are easier said than done. Since its founding fourteen years ago, De Beers Diamond Jewellers has been an exercise in value destruction.

For the above reason, it is a good idea to scrutinize De Beers' marketing ideas for the industry to check whether they are practicable. After all, how many industry players can afford 13 straight years of financial losses?

Anyway, I actually agree with De Beers that strong retail brands are the future of diamond retailing...but for a different reason.

I will explain shortly but let us start with a review of De Beers branding ideas. In my opinion, the branding ideas are not properly calibrated and that is why the vision is not proceeding according to plan.

From the Diamond Insight Report, here is De Beers' take on things:

Investment in branding, marketing and raised retail standards will help ensure that consumers, particularly among new generations and new markets, **do not drift away from the diamond jewellery category in favour of competing categories**, such as travel, coloured stones, electronic accessories or designer fashion.

Comment

I have studied the above paragraph about a dozen times and my conclusion is that De Beers still cannot see the forest for the trees. The company is too fixated on the success of categories that have little in common with diamonds except for the fact that they are all discretionary goods.

In general, all products and services are in 'competition' with each other for a share of consumer spending. Most shoppers are not rich folks so they have to prioritize how they spend their hard-earned money.

For goods and services, utility to be gained usually determines how much money is allocated to each good or service and at what point.

So in this context of 'competition', De Beers has offered the bright suggestion that retailers from the industry must spend more money on branding, marketing etc because such initiatives will let more people choose diamonds over i-phones and Luis Vuitton handbags, for example.

Well, De Beers Diamond Jewellers has impressive branding and presentation skills to rival the likes of Cartier and Louis Vuitton but sales have still massively underperformed projections for more than ten years. **If anything, this should tell you that product puffery and window dressing are not viable alternatives to actual selling.**

In this instance, De Beers is barking up the wrong tree and there are huge financial risks ahead for industry players who follow De Beers in pursuing this wrong course.

But do not get me wrong, I am not saying investment in branding, marketing and raised retail standards is not important. Far from it. Without doubt, such investment is often the difference between the success of one jewellery retailer and another. Awesome products require awesome presentation.

Investment in branding, marketing and raised retail standards **enhances competitiveness...but only in the context of the jewellery sector.** If I am looking to buy the latest i-phone, I am not going to change my mind and by a diamond necklace just because the jewellery shop next door was recently renovated and is now so much nicer.

So let us not obscure things by suggesting that people are not buying diamonds because Louis Vuitton stores look so much nicer than diamond jewellery stores or because i-phones are better marketed than diamond engagement rings. **There are fine margins in marketing...and these can either lead to huge financial success or huge financial loss.**

Anyway, many of you in the diamond industry desire to grow global sales of diamond jewellery so I am going to help you weed out things that will not help you generate amazing marketing ideas and impressive sales. Maybe this will help you focus your resources on what is really effective.

I am going to lift a bigger chunk of reference text from De Beers' Diamond Insight report because I want to show you that De Beers is looking at some of the right things...but interpreting them the wrong way.

Diamond Brands Future of Retail Trade of Diamonds?

FINE JEWELLERY IS FACING STRONG COMPETITION FROM OTHER CATEGORIES

It is clear that, as the US economy recovers from the financial crisis, the new consumer landscape holds both challenges and promise for diamond jewellery. **First of all, fine jewellery is facing strong competition from other luxury and experiential categories.** In 2013, fine jewellery was not among the top five on the list of gifts that US women would most like to receive, ranking behind holidays (foreign and domestic), electronics, home furnishings and spa days.

Comment

First, forget the idea that diamonds are in direct competition with other luxury goods. You are only being bogged down in things that will cloud your judgement and analysis.

Even among the new generations, how common is this conversation?

"Darling, I love you so much...will you marry me? To symbolize our engagement, I offer you this gift of the latest Louis Vuitton Handbag and a trip to Victoria Falls, Zimbabwe"

My point is, romance fuels sales of diamond jewellery and that is not about to change. In all key markets for diamonds, the idea of diamond as the ultimate gift of love is the driver of the diamond business.

Unquestionably, if this point is not well articulated, then marketing efforts will not produce optimal results. Worse, they may even fail completely...and to the financial ruin of many.

De Beers is combining things that are distantly related and presenting them to industry stakeholders as something that requires urgent attention.

Ok... let us suppose we are all working hard to make fine jewellery the number one gift that women would most like to receive.

Since, according to the list, we have these eight luxury and experiential categories ahead of us...how do we encourage women to ditch these gifts for diamonds?

For instance, if a woman desires a phone that vastly improves her video communication experience, how do you convince her that a diamond better fulfils her urgent priorities and desires?

Frankly, these lists only introduce pointless complications for jewellery marketers that pay attention to them in the wrong way.

So what is a better way of looking at these lists, if at all?

Well, **always look for context.**

For example, let us try to find context in this paragraph:

Among young people (aged 18-34), the desirability of fine jewellery ranked below branded luxury products such as designer handbags and clothing. However, diamonds were still the most popular choice for fine jewellery for all age segments; in fact, diamonds were almost three times more popular than any other type of jewellery.

Comment

Is this in the context of gifting or self-purchases? Is desirability for everyday purposes or for special occasions?

If I look at it from the general angle, I think most young people aged 18-34 would rank fine jewellery below many products that have daily utility in their lives. So I do not see anything that is amiss here.

Fine jewellery is simply not very competitive in fashion and fashion accessories where design and value for money are more important. On one hand, we have the limited earning power of those aged 18-34 years; on the other hand, we have fine jewellery...which is traditionally expensive.

Anyway, it is an actual global trend that consumers increasingly look to accessories as the most important part of their wardrobe. Jewellery is still popular as a fashion accessory but today's consumers want expensive and elegant fine jewellery for formal occasions and less expensive, more fashion-forward pieces for casual wear.

As for diamonds being the most popular choice for fine jewellery, I think that is rather obvious. Everyone knows diamonds are the big daddy of fine jewellery.

Part of the explanation for this relative weakness of fine jewellery in consumers' preference may be that **other luxury and discretionary categories have continued to compete far more strongly for consumers' attention.** Share of advertising voice for fine jewellery within the US luxury segment has declined over the last seven years (from 21 percent in 2007 to 13 percent in 2013 – see Fig. 34).

Comment

So consumers are not choosing fine jewellery because other sectors have increased spending on advertising? Is this the best explanation that De Beers can come up with? Does loudness of 'advertising voice' make people buy products? How many adverts do you reject in a single day?

Reversing the analysis, imagine the CEO of Prada telling shareholders that sales of Prada shoes and handbags are increasing because the company spends more money on advertising than Tiffany and Co.

What has Tiffany got to do with sales of Prada shoes and handbags? Does it not sound ridiculous and far-fetched?

De Beers still cannot see the forest for the trees and this is exactly what happens when you become fixated on the idea that different luxury categories are in direct competition with each other.

What if share of advertising voice for fine jewellery has declined because other sectors have increased advertising...**in response to greatly increased internal competition in their respective categories**? Or what if the percentage spent on advertising has remained the same for all categories but only that **sales of other categories have increased faster than sales of fine jewellery?**

Or what if the reason is because **there are now fewer jewellery businesses/stores in America as fallout of the recent deep economic crisis**? For one thing, I doubt that leading jewellers like Tiffany and Sterling Jewelers have slashed their marketing budgets as a percentage of sales.

Remember, the onset of severe economic stress started in the fourth quarter of 2008, a very important period for jewellery retailers. Loss of anticipated sales in such an important period severely damaged the financial health of virtually all jewellery retailers and large number never recovered.

Exhibit 1

Source: 2013-2014 USA Fine Jewellery Market – Equity Communications, December 2013

Please continue to next page...

Exhibit 2

Source: 2013-2014 USA Fine Jewellery Market – Equity Communications, December 2013

People buy fine jewellery infrequently even in the best of times so things can get dire quickly for jewellery businesses if consumer sentiment suddenly tumbles.

That being said, at least the folks at De Beers are trying hard to find solutions to problems that bedevil the global diamond industry. Some diamond producers only want to harvest where they did not sow. Add to this, we also have producer countries that do more than enough to destroy the image of diamonds.

But De Beers has to try harder. The diamond industry cannot really use most of what it has come up with so far.

If you are going to increase advertising for your jewellery business, do it because it makes business sense for what you are trying to achieve in the jewellery category. Do not do it because you heard Prada took up more advertising space on the billboards.

Diamond Brands Future of Retail Trade of Diamonds?

Overall, the fine jewellery category has been growing at a slower rate than other discretionary and luxury goods for some time (see Fig. 35). Luxury jewellery sales grew at a compound annual growth rate of just below two per cent between 2004 and 2013, well behind luxury electronic gadgets (14 per cent), fine wines (11 per cent) and premium beauty/personal care (eight percent).

Comment

Frankly, this is just true. But the reason hardly has anything to do with what other luxury goods producers are doing in their respective categories.

So let us get back to basics and start the analysis from there. I wish I could expand here on the basics but that would take too much time.

1. Diamonds used in jewellery are a perfect example of something that has 'acquired utility'. Generally, goods with acquired utility are valuable because people say they should be valuable - for emotional reasons.

Generally, the rarer a diamond; the higher the value attached to it. Nevertheless, for diamonds produced from the same mine, it costs the same to recover a diamond that is valued at US$1,000 and another that is valued at US$1,000,000.

2. Essentially, there will always be demand for diamonds in jewellery - whether they cost US$10 per carat of US$1,000 per carat - for as long as people use gemstones and precious metals for adornment (decorative jewellery).

Demand for diamond jewellery has relatively always been steady. However, **<u>sales are determined by the buying power of the world.</u>**

These are very basic points that are crucial to your understanding of diamond jewellery markets.

Let me break it down:

People use gemstones and precious metals for adornment. By extension, people buy diamonds for adornment. However, diamonds are expensive and that limits diamond sales for adornment purposes.

People use jewellery and precious metals as symbols - acquired utility. Okay, the most obvious example is the newly-wed woman. Her first act in her new role as "Wife" is to receive a physical gift of jewellery, which has absolutely no function other than to define her - the wedding ring on her finger lets you know she is married.

People buy diamonds to symbolize love and commitment. However, diamonds are expensive symbols of love and commitment and that limits sales.

As you can see, sales of diamonds for both purposes are determined by the buying power of the world. If buying power increases, diamond sales go up. If buying power decreases, diamond sales go down.

With the basics covered, let's now go back to what De Beers said so that we analyze it better.

Overall, the fine jewellery category has been growing at a slower rate than other discretionary and luxury goods for some time (see Fig. 35). **Luxury jewellery sales grew at a compound annual growth rate of just below two per cent between 2004 and 2013,** well behind luxury electronic gadgets (14 percent), fine wines (11 percent) and premium beauty/personal care (eight percent).

Comment

Let me start by repeating what I said earlier.

To most people, spending money in one direction means skimping in another. So money-spending usually has a serious purpose.

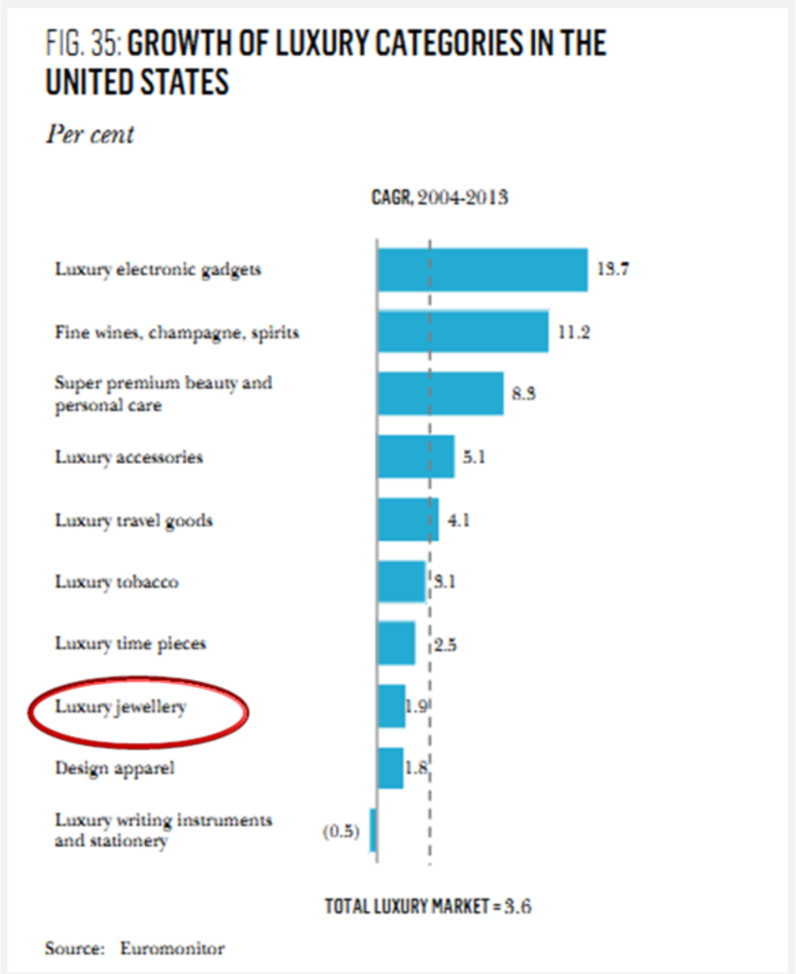
People want full value. They want something worth more to them than the same amount spent in other ways would buy.

Money comes slowly and by sacrifice. Few people have enough. The average person is constantly choosing between one way to spend and another.

We all know there was a massive economic recession for some years between 2004 and 2013.

And it is a fact that consumers do everything possible to stretch the dollar during times of economic stress. For this reason, consumption of expensive discretionary goods is the first to be slashed in an economic recession. It is also the last to recover when the economy eventually improves.

Exhibit 3



Source: De Beers' Diamond Insight Report, September 2014

If you look at the above chart, you can easily argue that strength of sales for each luxury category matches the economic utility generated in consumption - that is, the total satisfaction received from consuming a good or service. Appeal of the top-ranked categories is more defendable even during a recession.

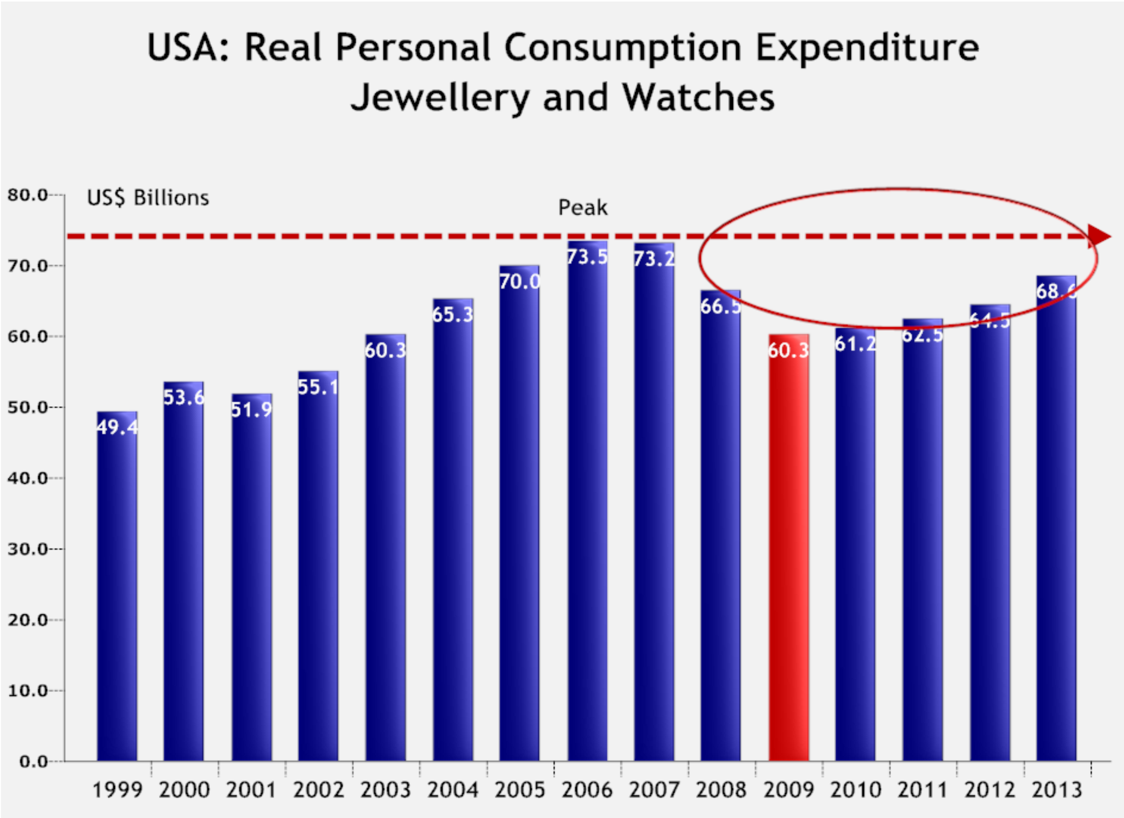
But the economic backdrop has greatly frustrated sales for the categories ranked towards the bottom.

Designer apparel is not so appealing when the option of a regular shirt means more money for food; Luxury jewellery is not so appealing when the option of a silver necklace means more money for the mortgage.

Emotion is what drives people to buy and this is particularly true for expensive products.

I am not just theorising here. Look at this chart on real personal consumption expenditure for jewellery and watches in America:

Exhibit 4



Source: U.S. Department of Commerce: Bureau of Economic Analysis

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Diamond Brands Future of Retail Trade of Diamonds?

Up until the onset of the mortgage crises in the US economy in 2007, diamond jewellery sales were exploding. With home prices skyrocketing and banks offering easy access to money, homeowners found enormous wealth in their homes and some of it was channelled into diamonds.

The subprime mortgage meltdown of 2007 and resulting rippling repercussions put an abrupt stop to heady diamond purchases. Diamond jewellery sales were further affected by the onset of the global financial crisis in the last quarter of 2008 and the recession of 2009, which greatly transformed consumption habits of Americans.

Exhibit 5

The Changing First World Consumer

	Era of Indulgence (Pre 2008)	Recession Consumer (2008-2012)	A New Realism (2013-?)
Ambition	Trading Up	Economising	Responsibility
Sensibility	Exuberance	Anxiety	Vigilance
Mindset	Bullish	Sober	Resourceful
Passion	Accumulation	Frugality	Prioritization
Orientation	Self-expression	Self-preservation	Connection

Adapted From Consumer Outlook Survey- Irish Food Board

Source: Global Diamond Business 2014 report – Equity Communications, August 2014

Overall, a more resilient and resourceful consumer is emerging from the pressures of the financial crisis. Consumers have begun to accept their current situation for what it is; the expectation that life will return to pre-recession days of indulgence has passed. Accordingly, consumers are starting to look forward but approaching life with a new mindset.

There is a shifting sense of priority emerging and different views in relation to how life and success should be measured - the rising feeling that there is more to life than money and material possession. A new era of realism is emerging, one where happiness now has more currency than affluence and economic growth.

However, this does not mean consumers have completely stopped indulging themselves. Consumers are still spending money on life's pleasures but they are prioritizing.

The worrying issue for the jewellery industry is that countless consumer surveys from USA to Europe and right across to Japan indicate that precious jewellery is not a priority anymore.

Really, the culprit is the economy.It is not that other product categories have discovered how to stifle sales of fine jewellery and tilt consumer spending in their favour.

Unfortunately, the diamond industry has limited room to manoeuvre in this case. **Economic problems mean that fewer people get to stages that traditionally require the purchase of fine jewellery.** Be on the lookout for this year's State of the Core Market for US Fine Jewelry Sales report to find out just how much things have shifted since 2007...in the context of the special occasions that generally drive fine jewellery purchases.

But you desire more diamond sales. You refuse to let the economy beat you down.

The economy is not in the best shape for everyone but other industries seem to be doing well.

So how can we increase diamond sales too?

There answer is straightforward but its implementation is complicated.

I am going to reference another huge chunk of text from the Diamond Insight Report and look at it from a different angle.

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Traditionally, two major segments of diamond jewellery have been analysed in the US women's category: bridal jewellery (including diamond engagement rings (DER) and diamond wedding bands (DWB)) and non-bridal jewellery (which can be further subdivided into married women's diamond jewellery (MWDJ) and single women's diamond jewellery (SWDJ)) – see Fig. 32.

Non-bridal diamond jewellery is the largest segment by value in the US. In 2013, it accounted for over four in five pieces and about two-thirds of sales value of women's DJ. However, compared with the pre-recession state of the US market, this segment has lost share both in volume and in value to the bridal segment (see Fig. 33).

This shift has been driven by two changes. Firstly, the number of DER pieces sold has increased and the average price per DER piece has grown even more rapidly than unit sales. The average DER price is more than three times higher than the average price for other women's jewellery. As a result, in 2013 DER accounted for a little over one in 10 pieces sold, but represented close to 28 per cent of retail market value of women's DJ.

Secondly, within the non-bridal segment, the two sub-sets – MWDJ and SWDJ – have behaved quite differently since the economic downturn. Over this period, the share of MWDJ has declined in volume of pieces, while its share of value has gone up slightly. At the same time, the SWDJ segment has retained its share of volume, but its share of value has declined.

These trends reflect, in part, the impact of the economic downturn experienced by married and single women in the US:

- **Married women in households most affected by economic pressures exited the category while those who acquired received more expensive pieces on average.**

- **Single women continued to acquire pieces but at lower prices on average.**

HIGHER-END JEWELLERY IS A FURTHER GROWTH OPPORTUNITY

Additionally, there are exciting growth opportunities in the US for high-end diamond jewellery. Average incomes for the top one per cent of Americans have grown much faster than national average wages. **In 2013, female consumers with household income of over US$150,000 accounted for eight per cent of the consumer base for diamond jewellery, but in terms of actual acquisition this group accounted for 14 per cent of diamond jewellery pieces and 33 per cent of sales by value** (see Fig. 38).

The presence of an affluent customer base for higher-end products has resulted in a shift of the profile of polished diamonds consumed in the US in the past five years. Large higher-clarity stones have grown notably, while all other types of polished have either declined or remained flat (see Fig. 39).

Comment

Ok, we can pick up **two key things** from this:

- In America, a man is expected to propose marriage to a woman with a gift of a diamond engagement ring. **The cultural practice is still going strong...particularly among high-income groups**

- Meanwhile, **fine jewellery demand continues to erode rapidly among low-incomes groups that were most affected by the recession**

Therefore, the most urgent issue for the American market is not branding and what not. **The jewellery industry simply has to restore fine jewellery sales among the low-income groups.**

Personally, if people cannot afford diamond jewellery, I would leave them alone until they can afford to. Times are tough.

But that is not what you want.

So this is what you could do:

Quite simply, diamonds now cost too much for the low-income groups and they have decided to forego consumption. **So the job required is to make the price of diamonds seem less.**

You do this by redefining issues for the low-income audience.

The cultural practice of diamond as a gift of love is still very much alive at the top...that means it can be revived at the bottom.

Basically, **you need to remind the low-income groups that diamonds are still an absolute requirement in the celebration of love-events**. You need to remind them that the standard has not changed or become less relevant.

For instance, psychologically, the price of diamonds can be whittled away if the industry reminds low-income groups that those who celebrate love events are most likely to have more fulfilling lives in the long run. The data is there and it can be manipulated accordingly.

For example, there is increased cohabitation among the lower income groups. However, studies show that women in long-term cohabitating relationships would prefer to be married to their male partners. Conversely, some men choose cohabitation because they cannot afford to get married. Weddings are costly.

But really, we can throw out the weddings and keep the symbols. Redefinition.

In the final analysis, people are like sheep. We judge things largely by others' impressions, by popular favour. We go with the crowd. If the trend shows that clear advantages accumulate to those who celebrate love events and milestones, it becomes very easy to lead more people in that direction.

However, this is easier said and done.

Who is going to spend a fortune investing in marketing projects that are going to benefit the whole industry...allowing others to harvest where they did not sow? Who can afford that?

Diamond Brands Future of Retail Trade of Diamonds?

The global diamond industry needs generic advertising of diamonds to keep vibrant the diamond dream...and less specialized advertising, which confuses issues for consumers. But who can afford the sacrifice?

The old De Beers could and thus the industry thrived.

Let me tell you why the old method of generic advertising worked so well to promote the diamond dream.

The diamond dream is psychological.

Social attitudes and the economy influence diamond sales far more than the promotion of competitive luxuries.

Generic advertising of diamonds meant that the diamond dream could flexibly be adjusted to match social attitudes of the day as well as the economic backdrop.

Anyway, it is now a different diamond industry.

According to De Beers, brands hold the key to growth of the USA market. Diamond brands are the new modern method that is supposed to cure old problems. Problems that the old De Beers could successfully solve in the past.

But can the inflexibility of brands adequately address the challenges faced by the diamond dream in a dynamic social and economic environment?

That being said, I agree that brands are the future of the diamond industry. However, I just do not agree that growth of diamond brands will necessarily lead to more sales of diamonds. It does not follow automatically.

For instance, De Beers Diamond Jewellers closed more shops in America and shifted attention to emerging markets. However, the high-end of the US market is apparently doing well, so why has it been necessary to close these shops?

Frankly, if the goal is to increase diamond jewellery sales, then De Beers' ideas on brands are borderline rubbish.

This is what De Beers' has said about it:

Raising fine jewellery's place to the top of the desirability list is not a simple matter. As discussed in the retail section of this report, US jewellers have been under financial pressure and find it challenging to invest in innovation and advertising to boost the category.

Despite the challenges facing fine jewellery in the US, there are promising opportunities for growth in diamond jewellery. The premium and bridal segments continue to expand. The rise of brands and premium products means that retailers have the opportunity to realise higher margins necessary for investing in desire-creating activities.

BRANDS HOLD THE KEY TO GROWTH

Brands are becoming more important to the US consumer. The acceleration in consumer preference for brands of diamonds and diamond jewellery is evident from the claimed acquisition of branded engagement rings – from just seven per cent in 2002 to three and five times that level in 2011 and 2013 respectively (see Fig. 36). **The growth in importance of branded jewellery will have a particular impact in attracting the brand-conscious younger US consumer.**

A variety of brands has been gaining space in the US market for diamond jewellery in recent years. There has been an uplift in awareness of specialist diamond brands such as Hearts on Fire, Leo and Tacori. Traditional branded jewellers such as Tiffany and Cartier have seen a jump in claimed brand acquisitions in the last couple of years, and fashion brands such as Dior and Chanel are also growing. Forevermark has been part of this trend and has experienced growing retailer and consumer interest since its US launch in Q4 2011.

Comment

I encourage careful consideration before anyone rushes off to launch a new diamond jewellery brand. While it is true that brands are gaining a greater share of diamond jewellery sales, it is long established brands that are finding the most success in this space.

Moreover, there is gradual re-alignment of the diamond jewellery market with diamonds brands taking away market share from non-brands. However, the total market size is still below the 2006 peak.

So how should we interpret branding in the diamond industry context?

Branded diamonds and branded diamond jewellery present a growth opportunity for diamond jewellery retailers in both developed and emerging economies. Consumers worldwide increasingly prefer branded products and services. Brands can also be an attractive financial proposition for retailers because the brand identity frequently offers differentiation from generic propositions. The additional revenue that can be generated from brands should make it possible for retailers to invest in their store environment and in promoting their businesses and the category, leading to a virtuous circle of growth.

Comment

With individualism on the increase worldwide...it makes sense that brands have gained traction. The diamond industry is not excluded from this.

But we have to be brutally honest about it:

The "branding" ship sailed a long time ago and it is probably too late for most industry players to catch up. If De Beers Diamond Jewellers is struggling to firmly establish itself in that space, what are the chances of success for smaller industry players?

For fun, I once wrote a checklist of what it probably takes to establish a global diamond brand from scratch. Please indulge me for a moment:

Please continue to next page...

How to build a global diamond brand - Five Simple Steps to Follow

*1. You require consistent **supply of the right kind of diamonds** for your brand over at least ten years.*

*2. You need to build **a store network of at least 50 stores** located in the major global gateway cities. That's where you will find your target market from all over the world.*

*3. You need **inventory of at least US$5 million per store** - for products at different price points starting at US$1 000 to as high as $100,000. Different consumers have different requirements - engagement rings, earrings, pendants, necklaces etc*

*4. You need to spend about **US$70 million in marketing per year**. People nowadays have so many different things vying for their attention today so it is harder to get their attention and much more expensive.*

*5. You absolutely **must have very deep pockets.** It is highly improbable that you can achieve profitability within the first ten years. If De Beers and LVMH owned De Beers Diamond Jewellers couldn't do it, you probably can't do it too.*

Sadly, you will probably stumble at the first hurdle and that is a good thing. Unless you are De Beers Forevermark, it is highly unlikely that you will be able to access a consistent supply of the right kind of diamonds to build a diamond brand over ten years.

It is recommended that you abort your project and focus on other enterprises with greater potential for fruitful outcomes. In any case, beautiful diamonds come from nature. Branding a diamond has nothing to do with it.

However, if selling diamonds is what you really want to do, then be like Tiffany. Strive to be known as the go-to guy (or lady) for beautiful diamonds that are hard to find. Soon enough, your reputation becomes the brand. That is how you build a global "diamond brand". The most popular "diamond brands" are actually retail luxury brands.

Diamond Brands Future of Retail Trade of Diamonds?

So what's the deal with diamond brands?

The branding movement in diamond retailing is the **result of successful economic opportunism.** This is where De Beers and others often get it wrong.

Perhaps you know that Apple, Inc is leaning on its sterling reputation earned in mobile gadgets to try to expand into the luxury watch business.

Similarly, established designer brands have noticed the opportunity available in jewellery and are now leveraging reputations earned in fashion and accessories to launch jewellery lines. These jewellery lines are resonating with consumers including in the important bridal jewellery segment.

Even traditional powerhouse luxury brands like Louis Vuitton and emerging powerhouse designer brands like Michael Kors are launching collections and finding success in the jewellery space.

This is because today's jewellery consumers are very much focused on styling and design - a theme very much in tune with the individualism trend. **If consumers are not able to customize jewellery and make it their own creations, they are going for reputable jewellery brands and jewellery by well-known designers - brands that they identify with in related areas.**

For this reason, **it is inevitable that these powerhouse brands are going to steal market share from companies that have traditionally sold diamond jewellery. For one thing, their marketing budgets and experience easily overwhelm the traditional industry retailers.** Look at the Chanel Case Study (page 30) in De Beers Insight Report to get a sense of the power of these invaders.

Indeed, powerful retail brands are the future of diamonds...but mostly because <u>the economics of the diamond business are becoming less attractive for companies that do not have strong balance sheets.</u> The diamonds business is capital intensive for any jewellery retailer and only companies with strong balance sheets/cash flow can afford to horde the best diamonds.

Diamond Brands Future of Retail Trade of Diamonds?

If you traverse the global diamond retail landscape, you soon realise **it is strength in other areas that enables companies to survive and flourish in the modern diamond retailing business.**

- Premium luxury brands - strong brand appeal for high margins.
- In the East - high volume gold jewellery sales for companies like Chow Tai Fook provide the necessary cash-flow to offset diamond inventory carrying costs.
- In USA, the ability to provide consumer credit drives diamond sales of leading jewellery chains.

Anyway, this issue of diamond brands need to be well articulated in the global retail context so I am just going to copy and paste the remainder of this section from the Global Diamond Business report.

Please continue to next page...

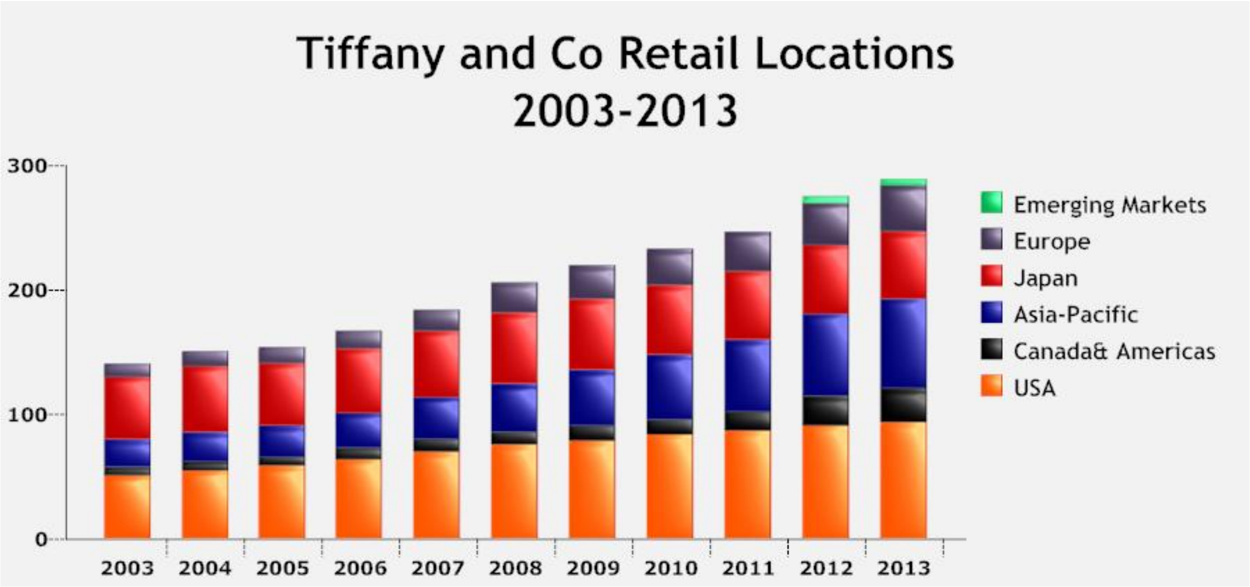
Diamond Brands Future of Retail Trade of Diamonds?

Premier luxury brands set to dominate diamond jewellery sales and global gateway cities set to dominate diamond jewellery retailing...

Economic development efforts of key populous countries gained enough momentum to be significantly impactful on the global stage by the beginning of this millennium. The ripple effects of this juggernaut have been enormous, resulting in a transformational rearrangement of the world's spheres of influence.

In essence, the number of people with money to spend is swelling worldwide, opening up new markets for premium luxury goods. Accordingly, purveyors of luxury goods have expanded sales networks to these emerging centres of wealth and attained great profit.

Exhibit 6



Source: Global Diamond Business 2014 report

For instance in the last ten years, Tiffany and Co - known for stocking beautiful diamonds - has increased the number of its retail locations by 227 percent in the Asia Pacific region, 286 percent in Latin America and Canada, 236 percent in Europe, 8 percent in Japan, 84 percent in USA and 500 percent in other Emerging Markets. That is to say, 289 retail locations at the end of 2013 compared to 141 retail locations at the end of 2003.

Diamond Brands Future of Retail Trade of Diamonds?

Prior to the Global Financial Crisis, about 85 percent of consumer demand for diamonds was located in developed diamond markets such as USA, Canada and Japan. Post-crisis consumer demand for diamonds has become a bit more globally diversified largely because of growing demand from emerging markets - led by India and China.

However, while global expansion of diamond markets is a good thing for growth of the diamond industry, it also increases competition for the best diamonds and intensifies competition for customers in the diamond industry's value chain.

Essentially, enhanced global competition for increasingly costly high quality diamonds - and the fact that the world has become one market in the internet age - will disqualify even more jewellery retailers and retail locations from the diamond business.

First, offline (brick and mortar) retail channels are losing consumer traffic to online (internet) retail channels. The shift is global. Many retail locations that sell diamond jewellery become less profitable with reduced store traffic because of high inventory carrying costs and lower margins.

At the same time, the online diamond business has really made things much more transparent and better for customers since all the diamond choices out there are literally available at their fingertips. However, price transparency at the retail level has introduced price competition to the industry and lowered polished diamond prices by up to 40 percent over the years, to the continued ruin of retailer margins.

For the most part, consumers are now known to price-compare before finalizing a purchase. As you know, the internet is the ideal environment to pit one seller versus the other and allows the laws of supply and demand to set the most efficient price. Consequently, retailers who sell comparable diamonds at a premium have been forced to reduce prices in order to move stock.

Correspondingly, there literally is even less margin for error in emerging diamond markets like India and China where the adornment+investment factor is a huge component of jewellery consumption.

Diamond Brands Future of Retail Trade of Diamonds?

For the above reasons, it is reasonable to assume that more of the diamond retailing business will migrate to luxury retail brands and global gateway cities in the coming years.

There is emotional buying at the upper end of the consumer spectrum, therefore luxury brands have the ability to defend higher margins in the face of rising costs and enhanced competition. Conversely, there is value-driven buying at the lower end of the consumer spectrum, therefore regular jewellery retailers find it harder to pass on higher costs to consumer.

Exhibit 7

Luxury Retail Brands versus Regular Diamond Jewelry Retailers

	Consumer Spectrum	Customer Purchase Decision	Customer Attachment	Margins	Marketing Budgets
Luxury Retail Brands	Upper end	Brand Emotion	Strong	Higher Gross (40-70%)	Deep
Regular Jewelry Stores	Lower end	Value-driven	Weak	Lower Gross (20-50%)	Shallow

Source: Equity Communications

Source: Global Diamond Business 2014 report

Using the example of Tiffany, for one thing, the luxury brand retailer can sell sterling silver jewellery pieces for US$300 and achieve great margin success because desirability of the brand is the most important thing for its customers.

Diamonds, like silver, are a commodity; however, brands are not. Luxury brands have gained strong desirability over time and this translates into pricing power. Pricing power translates into margin success and ultimately profit.

Please continue to next page...

Diamond Brands Future of Retail Trade of Diamonds?

Turning now to the physical aspect of the diamond retailing business, we believe global gateway cities are the prime real estate of the present and future since they provide the most potential for sustainable diamond jewellery retailing.

Global gateway cities are cities that serve as cultural and economic hubs of a region. These cities possess the ability to attract a constant flow of human traffic from within the country and from other countries - becoming vast melting pots of people, trade and innovation. Cities like London, Paris, Milan, New York, Miami, Beijing, Shanghai, Singapore, Dubai, Hong Kong, Miami, Moscow, Geneva, Tokyo and Berlin etc.

Global gateway cities are often quite divorced from the local economy of a region - taking cues from the global economy - and tend to attract large numbers of wealthy travelers with money to spend. Unfortunately for regular retailers, the downside is that global gateway cities are often the preserve of global luxury brands that afford astronomical rents.

At the global level, emerging wealth flocks to gateway cities to purchase jewellery and luxury goods because of higher luxury taxes at home and the prestige factor. For instance, Hong Kong has benefitted tremendously from wealthy Mainlanders who visit the city for luxury shopping. London is also a popular shopping destination for wealthy Africans.

Incidentally, tourist shopping in many of Europe's gateway cities has sustained luxury retail locations since domestic demand is currently weak. For instance, foreign tourist spending represents more than a quarter of Tiffany sales in Europe.

Please continue to next page...

Exhibit 8: Tiffany and Co – Sales Impact of Stores Located in Global Gateway Cities

- Tiffany's New York Flagship store represents 8% of worldwide sales - about US$320 million. Sales to foreign tourists account for approximately 45% of store sales.

- Tiffany has 54 locations in Japan but the store located in the luxury shopping district of Ginza in Tokyo accounts for more than 10% of total sales in Japan

- Tiffany has 45 stores in Greater China but the store located on the prestigious Canton Road in Hong Kong is the companies highest volume store in the region by a considerable distance. Canton Road is very popular with tourists from the Mainland.

- Sales in the U.K represent 40% of Tiffany's sales in Europe. The store located on Old Bond Street - popular with tourists from all over the world - is Tiffany's highest volume store in Europe.

Source: Global Diamond Business 2014

Please continue to next page...

Diamond Brands Future of Retail Trade of Diamonds?

Gateway cities will continue to attract wealthy shoppers therefore it makes sense for jewellery brands to gravitate to such cities, particularly in the retailing of expensive high-quality jewellery. Furthermore, jewellery brands have to strive to create the widest possible network of retail stores in gateway cities because sometimes consumers will buy less in Hong Kong, less in Paris, more in Dubai, and more in London.

Dynamic things that change all the time such as the weather, taxes, airline routes and currency movements are considered carefully by luxury goods shoppers in the planning of foreign shopping trips. In essence, the shopping experience has become more important than ever and the appeal of different shopping destinations changes all the time.

Naturally, only brands that travel well can go international. Travelling well also entails having adaptive websites that provide the same high quality user experience whether access is from laptops, tablets, or smartphones.

Numerous studies and surveys indicate that tourists use the internet to plan their shopping while still at home and update shopping plans while on the go. The wealthy expect the same level of high quality service from luxury brands no matter the location or device.

In the final analysis - by and large - pace of growth of emerging diamond consumer markets will depend on the expansion strategies pursued by luxury brands like Tiffany, Van Cleefs and Arpels, Graff Diamonds and other prestigious and well established jewelry brands like Chow Tai Fook in Greater China and Damas Jewelry in the Middle East.

In established diamond markets like the USA, retailing of diamonds will consolidate into strong and well-established national retail chains like Kay Jewelers and Jared both owned by Sterling Jewelers.

After all, these companies have some important advantages in common:

They possess the ability to capitalize on their stronger brand names, higher margins, stronger marketing and advertising budgets, and deeper capital resources for sustainable diamond jewelry retailing in a global environment that has become more competitive and volatile.

2. Consolidation To Get Rid Of Industry Dead Weight?

Consolidation To Get Rid of Industry Dead-Weight?

Two views on diamond industry consolidation

PRESSURE ON THE MIDSTREAM IS LIKELY TO LEAD TO PROFESSIONALISATION AND CONSOLIDATION

Financing challenges are increasingly critical and could intensify over the coming years. Rising inventory costs, and diamond banks' drive to constrain the growth of their lending to the midstream, will mean financing costs are unlikely to decrease, particularly if the trend of low interest rates begins to change.

Additional financial scrutiny of the midstream sector can therefore be expected. Leading banks in the diamond sector have come to realise that they have been taking equity-type risks in the diamond midstream without getting the corresponding returns. This is now changing and, as a result, borrowing costs are going up while banks are asking their borrowers to professionalise their capital management.

Overall, this trend is expected to affect the way the industry operates. New lending standards will increase the regulatory burden on the midstream, leading to higher costs and operational complexity. **One possible consequence is that less well-established companies may even exit the industry, leading to some level of consolidation.**

Over time, those firms that are able to add significant value in the diamond cutting and polishing process are more likely to be successful.

******

A possible response to rising consumer expectations, and the increased investment required to support them, could be retailer consolidation. In fact, **given the recent weakness in the world's economy and the number of underperforming retailers, consolidation might already have been expected to happen.**

Source: De Beers' Diamond Insight Report September 2014

Consolidation To Get Rid of Industry Dead-Weight?

If you desire a big picture view, everything that is happening in the diamond industry at this moment points to greater consolidation in the coming years. Right across the industry value chain or pipeline. Current expansion and volatility in the global diamond industry will give birth to long-term stability.

Within a decade, we will likely have a leaner but ultimately stronger diamond industry. A few companies will continue to dominate diamond mining; diamond processing will grow in Africa with the transfer of technology and accumulation of processing skills; global processing over-capacity will become a thing of the past after massive shakeout in India; few specialized diamond banks will dominate industry finance, while the world's big banks steer clear of the diamond industry; and retail markets will be dominated by large multinational corporations with strong brands and balance sheets.

Fundamentally, the diamond industry will rise in value as has happened with other global industries that have consolidated. In the long term, revenues will increase for everyone who survives the great shakeout.

Greater consolidation of retail markets for diamonds is also likely. As diamonds become more expensive, fewer consumers will afford them and fewer companies will have the deep financial resources to maintain stores in poor performing regions.

Ten years from now, the big three markets of USA, India and China will likely dominate sales of diamond jewellery. Moreover, retailing of diamonds could consolidate in gateway cities of the world - places like Tokyo, London, Paris, Milan, Mumbai, Shanghai, Dubai, New York, Miami, and Hong Kong etc.

Source: Equity Communications' Global Diamond Business 2014 Report August 2014

Please continue to next page...

Comment

The greatest level of consolidation will be concentrated in the mid-stream. It just makes business sense. Specifically, there are fewer diamonds to cut and producer countries are demanding that more diamonds be processed locally.

Exhibit 9: Industry Cutting and Polishing Jobs

CUTTING CENTRE	APPROXIMATE CUTTING AND POLISHING COST USD/CARAT [i] 2008	2013	APPROXIMATE TOTAL CUTTING AND POLISHING JOBS 2008	2013
Canada	125	140 NWT 180 Ontario	300	50-80
Botswana	45->125	60-120	2,200	3,750
Namibia	45->125	60-140	1,500	970
Belgium	120	150+	1,000	150-200
US	110	300	100	80-100
South Africa	60-100	130-150	1,800	1,000
Israel	47->55	140->300	2,000	400
Far East	15-35	20-50	29,000	10,000
India	6-50	10-50	850,000	800,000

Consolidation

Producer countries are gaining share on the back of government policy, despite higher costs than traditional manufacturing locations

'Old' cutting locations have lost share of manufacturing following migration first to low-cost locations and subsequently to producer countries

The trend of growth in low-cost locations has recently started to reverse

i These are estimates for the majority of production units and exclude outliers

Source: De Beers estimates

Source: De Beers' Diamond Insight Report, September 2014, Equity Communications edits

Diamond producers are not going to quote lower prices for rough diamonds in order to restore profitability for the mid-stream. Therefore, there is currency in the idea that all the rough diamonds produced in a single year can be processed by 200 to 250 mid-sized companies, each with annual sales of up to US$100 million. In theory, such consolidation would allow for the transfer of higher rough diamond prices to polished diamond markets.

Profit levels in the diamond pipeline are no longer as exciting as they used to be. An analysis of the evolution of the global diamond industry can show us where things went wrong and how they can be corrected.

Consolidation To Get Rid of Industry Dead-Weight?

First, imagine this scenario:

A diamond producer has large-scale deposits of diamonds that it wishes to exploit for profit. Let us assume there is initially zero promotion of the diamond dream and zero consumer demand for diamonds. So how does the producer generate consumption of diamonds in such a situation?

Obviously, an unadvertised product without consumer demand must depend on distributors.

Now, in such a scenario, this is how distribution works:

The diamond producer convinces other businesses that distribution of diamonds can be profitable.

Distribution becomes the job of polished diamond manufacturers and traders. These can distribute polished diamonds to jewellery manufacturers and retailers...for a slice of the profits (division of labour). They can set up rough diamond processing centres in low cost regions(e.g. India) and then trade the resulting polished diamonds in trading centres that have a large population of other polished diamond dealers, jewellery manufacturers and jewellery retailers etc (e.g. New York and Hong Kong)

Such an arrangement works amazingly well with one dominant producer. Furthermore, the producer and distributors are able to set aside a portion of the profits generated and use the money to promote diamonds in consumer markets - generic promotion of diamonds.

More diamond sales are in the interests of everyone involved.

However, suppose another producer appears on the scene with diamonds that also require distribution. Obviously, the best way for this new producer to distribute diamonds would be to piggyback on the pipeline created by the first producer.

The second producer can do that by offering a larger slice of the profits to distributors employed by the first producer. Producer number two has not spent anything to develop the pipeline nor does it spend anything to maintain it...and that is why it can afford to offer distributors a larger slice of profits.

Consolidation To Get Rid of Industry Dead-Weight?

If there is room for another producer, the first producer will likely accept the situation. Its diamonds are still being distributed to consumers and there is no real loss of market share.

But suppose there is no room for another producer. In this case, producer number two immediately becomes a deadly competitor. Every diamond distributed by producer number two prevents producer number one from supplying demand.

The new situation soon becomes very bad for the first producer. Its place in the market is now at serious risk. It can see stocks of undistributed diamonds piling up in its storage facilities. A competitor has come along to harvest benefits from a situation it did not help create.

Producer number one can respond to the threat in a number of ways:

1. It can buy producer number two and recreate a monopoly.

2. It can enter into a partnership with producer number two and gain control of its diamonds.

3. It can flood the market with diamonds and destroy profitability for producer number two

Now, if you are quick to grasp things, you can tell that producer number one is De Beers and producer number two represents all other diamond producers that entered the market after De Beers.

Before the turn of the millennium, De Beers could deal with competing producers in any of the above ways...and that is how it maintained its monopoly position.

But times have changed; it is a different world today. De Beers is no longer allowed to distribute rough diamonds produced by other producers for anti-monopoly reasons.

More importantly, promotion of diamonds was the responsibility of De Beers when it exclusively sold much of the world's annual production of diamonds. It collected levies from other pipeline participants and used the funds to promote diamonds in consumer markets.

De Beers no longer affords generic promotion of diamonds for the benefit of the whole industry since it no longer gets financial help from other pipeline participants.

Consolidation To Get Rid of Industry Dead-Weight?

This brings us to scenario number two:

Ok, again, let us assume there is zero promotion of the diamond dream but sufficient consumer demand for diamonds has been achieved.

Furthermore, a number of diamond producers and distributors now exist to satisfy this demand.

But the problem is that the profit available in the diamond industry is no longer adequate for everyone.

As an aside, that is also how you can tell diamond consumption is not growing as fast as most people would like to believe. An industry that is growing fast does not consolidate at this level.

Anyway, since profit available is no longer adequate for everyone, it can be increased in three ways.

1. The consumer market for diamonds is expanded

2. The number of players in the diamond industry is reduced

3. A combination of number one and two

Number one increases the size of the market for everyone...more sales equals more profit to share

Number two means that fewer people can participate in the market...same level of sales but more profit to share

Number three is the best....more sales for fewer participants

Again, if you are quick to grasp things, number three is what is currently happening in the diamond industry.

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Consolidation To Get Rid of Industry Dead-Weight?

To grow consumer demand for diamonds, the diamond industry has to expand the geographical market for diamonds. It has achieved this by expanding into China, for example.

However, since generic promotion of diamonds is not an option (no single player can afford, so it has to be a collective effort) the industry has to rely on the individual efforts of industry players.

To reduce the number of players in the diamond industry, the obvious thing is to get rid of dead weight in the industry.

Here is a working definition of dead weight:

dead weight - *A person who just takes up space and has nothing to really offer any of his or her peers. Someone who is just not a team player and may even be considered a brick wall to some*

Many industry players in the mid-stream complain about shrinking margins and greatly diminished profitability. But that aspect of the diamond business is commoditized, with a lot of extra participants (dead weight). Skills are relatively easy to master and the main competitive advantage is access to good quality rough diamonds... which is rather dependent on the benevolence of rough diamond producers.

So there is active movement to get rid of dead-weight in the mid-stream.

Let me show you how you can identify dead weight.

The way I see it, anyone who cannot survive the low-margins that exist today in the mid-stream is being pushed out. De Beers and other producers can no longer afford generic marketing of diamonds so they prefer to partner with those that are in a position to help with the marketing.

To this end, producers are quoting higher prices for rough diamonds and entering into supply agreements with vertically integrated companies that can recover costs further down the diamond industry value chain.

However, De Beers is taking it to another level. The company desires to get rid of dead weight in all stages of the diamond industry value chain. **Perhaps the subtle changes in the marketplace require your close attention.**

3. De Beers Using Forevermark To Reclaim Control Of Diamond Industry Pipeline?

De Beers Using Forevermark to Reclaim Control of Diamond Industry Pipeline?

De Beers desires to get rid of dead weight in all stages of the diamond industry value chain.

Here are some of the reasons why De Beers is likely annoyed:

1. If we exclude De Beers and Rio Tinto Diamonds, the other diamond producers are not very active in the marketing of diamonds in consumer markets. Yet they also harvest benefits from the efforts of these two producers

2. Then there are diamond producers who do more than enough to ruin the image of diamonds, including unscrupulous producers of lab-created diamonds

The diamond pipeline is now being remodelled to emphasize that diamonds from different producers should not be treated equally. The movement has been growing for years and attention now appears to have shifted to polished diamonds. The movement seeks to devalue diamonds produced that carry significant reputational risks through their exclusion from marketing initiatives in consumer markets.

Make no mistake about it, De Beers is very aggressive about its vision for the diamond industry and remains determined to create a diamond pipeline more in tune with its ambitions for the industry.

Furthermore, De Beers is absolutely sold on the promise of diamond brands. If you do not buy into this vision, you are likely to be excluded from the De Beers network.

With this in mind, many people dismiss Forevermark, De Beer' weapon for change, as a negligible part of the overall De Beers business. However, De Beers' ambitions for Forevermark transcend the present.

Forevermark is a brand targeted at consumers as well as the diamond industry pipeline. It is fast gaining momentum and soon competing industry players will have to respond.

Here is why...

De Beers Using Forevermark to Reclaim Control of Diamond Industry Pipeline?

According to De Beers' Diamond Insight report, these are actual retailer quotes on impact of Forevermark on their business:

"When I was initially introduced to Forevermark, I was very intrigued by Forevermark's brand promise and, more importantly, **how partnering with De Beers and Forevermark could elevate my brand and increase my margins.** In the year and a half that I have been involved with Forevermark, I have seen an increase in margins anywhere from 15 to 30 percent. I am sometimes seeing a 35 percent increase on loose goods, compared with the equivalent unbranded polished since **I am not competing with other jewellers and online companies who are selling inferior Gemological Institute of America (GIA) graded stones for little to no margin.**"

Comment

If you missed it, I would like to draw your attention to the key phrase in this paragraph...the one that refers to inferior Gemological Institute of America (GIA) graded stones for little to no margin. Stop for a moment and consider what De Beers is really saying...

Here is another quote from the Diamond Insight report:

"Since partnering with Forevermark, the sheer beauty of the diamonds, exclusivity of the brand, and the other value added features have **enabled us to ask for margins at 15 to 30 percent higher than we had for GIA certified diamonds.** We have been able to achieve it with great success."

Comment

I will tell it like it is...**De Beers is insinuating that diamonds graded at its Forevermark Institute in Belgium are more marketable than diamonds graded by the Gemological Institute of America (GIA) and other grading laboratories.**

De Beers Using Forevermark to Reclaim Control of Diamond Industry Pipeline?

So what is De Beers up to?

Strictly speaking, there is no official standard for the grading of diamonds. Nevertheless, the most widely accepted gradings are those set by the Gemological Institute of America (GIA). GIA invented the grading system, otherwise commonly known as the 4Cs – carat, cut, clarity and colour, back in 1953. That system and its terminology became the standard in the industry, and all the grading services use it today.

Unfortunately, that system and its terminology have now been abused extensively.

Once again, the issue of different grading labs providing different colour and clarity grades for the same or similar diamonds has taken centre-stage among diamond traders...as this influences the final value of a diamond.

As I write this, there is current controversy surrounding diamonds graded by the European Gemological Laboratory (EGL). EGL is accused of routinely certifying diamonds as being worth more than they really are.

As a result, Rapnet and Polygon no longer allow the listing of EGL graded diamonds on their trading platforms. Idex still allows the listing of EGL graded diamonds.

But do not be surprised if none of the long-established grading labs comes out ahead in this fiasco. Rather, look to the young Forevermark Diamond Institute and its 5Cs grading model for the likely future of diamond grading and certification.

De Beers is quietly improving grading systems at its Forevermark Diamond Institute, targeting consistency. The company is working with proprietary colour grading machines at the grading facility in Antwerp that have so far proved to be more consistent and reliable than human graders on colour and clarity. The machines work at high speeds (faster out turn).

Crucially, De Beers is not willing to share the technology with other grading labs.

Any grading lab that achieves a high level of consistency in its grading reports immediately stands above the rest.

De Beers Using Forevermark to Reclaim Control of Diamond Industry Pipeline?

The Forevermark Diamond Institute is used solely for the purpose of evaluating, inscribing and grading Forevermark diamonds. Nevertheless, it does some private label grading for qualifying diamond brands that meet its stringent requirements.

To cater for the wider market, De Beers established the International Institute of Diamond Grading and Research (IIDGR) to evaluate and assess non-Forevermark diamonds using the same methods. In other words, IIDGR is basically Forevermark grading but with the branding associations stripped out.

Diamond certification is an important component of the diamond purchase decision in emerging markets where consumers are less trusting of diamond retailers. Therefore, Forevermark and IIDGR are moving in to capture significant market share based on the back of their strong marketing push.

De Beers is in the process of setting up a second IIDGR base in India, which is expected to enter into direct competition with long established gemological laboratories such as Gemological Institute of America (GIA) and International Gemological Institute (IGI).

Believe me when I say that Forevermark is going disrupt the status-quo.

Take a closer look at the following text from the same Diamond Insight Report:

Please continue to next page...

Britney's Journey (American Consumer - Chicago)

For as long as she could remember, Britney had known she wanted a diamond engagement ring. As soon as her fiancé proposed, she went online to search for rings.

“When I Googled engagement rings, Tiffany was the first website to pop up. I used its ring finder to get an idea of styles and cuts – and decided I wanted a cushion cut.”

Shortly afterwards Britney and her fiancé Kevin went to try on rings. They made a special trip to the mall where they could browse a number of high-end department stores and jewellers in one go.

At one of the stores, Britney was shown a Forevermark diamond. She loved the beauty of the diamond and the sales assistant showed her and her fiancé the inscription. They told her about registering the ring online, and how it was responsibly sourced.

“I really loved the Forevermark diamond, but it was a bit more expensive than some of the other rings, and slightly more than our agreed budget. The sales assistant was lovely but I told her I had to go home and think about it.”

A few weeks later, Kevin returned to the store where they had seen the Forevermark diamond and bought it.

“I couldn’t believe it when Kevin pulled out the box and I saw it was from Forevemark! I guess I secretly hoped he would get it. It was such a nice surprise!”

A few months later, the couple returned to the same store to buy their wedding rings, which they had tried on earlier when they were browsing for engagement rings. Kevin’s was plain, but Britney wanted a few diamonds on the wedding ring as well.

Britney also used this occasion to buy a pair of diamond earrings – a gift from her parents to wear on her wedding day.

“I’m very proud of my ring and love it when people ask me about it –I can tell them all about the inscription and the fact it is responsibly sourced.”

JI LAYMAY'S JOURNEY (Chinese Consumer - Shanghai)

Ms Ji planned to buy a diamond ring because her wedding was approaching. She thought that a diamond ring was a necessity for her marriage. Her friends recommended she go to the Tiffany and Cartier stores to have a look. However, the prices were too high for her.

Ms Ji decided to learn more about diamonds on the internet before continuing her search. That is the first time she noticed the brand Forevermark, although she did not click the link. Online, she learnt about the 4Cs and browsed various designs and cuts.

Ms Ji's elder sister recommended she go to the Donghua store. She thought that the store was reputable and had a good selection. Ms Ji went to Donghua on North Sichuan Road. There she noticed the Forevermark counter and went to see the products. The salesman told her that every Forevermark diamond is unique and has an invisible inscription with a unique number.

This information about Forevermark attracted Ms Ji a lot, so she came back home and searched for more information about the brand on the Forevermark website. Here she noticed its rarity (only one per cent of diamonds make the Forevermark grade) and its responsible sourcing promise. This gave Ms Ji a good impression that Forevermark was a high-quality product.

Ms Ji went to some jewellery stores on Nanjing Road, such as Laofengxiang, Xieruilin and Laomiaohuangjin, but none of their products attracted her. Finally, she went to the Donghua store which is located in Nanjing Road. She went to the Forevermark counter and chose a 75 point diamond solitaire to try. The salesman gave her another two (60 points and 70 points) to compare.

Ms Ji didn't make her decision at once. She came back home and had a long think about the three diamonds. In the end, she thought the 75 point ringoffered the best value for money. The next day, she went to the store and bought it.

De Beers Using Forevermark to Reclaim Control of Diamond Industry Pipeline?

Comment

I am not happy with the tone taken by De Beers in that section of its Diamond Insight Report. Urging people to buy from you instead of others goes against the grain.

I am also surprised De Beers is throwing shade at virtually the whole diamond pipeline and not even one person has responded. **If GIA graded diamonds are <u>inferior</u> to Forevermark diamonds, then the Forevermark Diamond Institute will eventually replace GIA and all other grading labs.**

Nevertheless, the public trashing of grading labs used by the rest of the industry suggests De Beers is ready for battle.

De Beers has looked at the competition, what the rest of the industry is offering in this area...and what consumers want from diamonds. That means it believes the advantages are strongly on its side.

Well, I do not have any skin in the game but De Beers has probably moved ahead of the whole industry with its Forevermark plans.

For one thing, many people seem to forget that, even though De Beers did not own any retail business until 2001, it actually did the selling of diamonds in consumer markets...through its brilliant marketing initiatives.

Now De Beers wants to create strong demand for the diamonds it produces but without the burden of having to carry the whole industry on its shoulders.

I also believe De Beers still wants to treat the rest of the diamond industry fairly. However, it has just decided to stop paying the rest of the industry for what they have shown they cannot do...the art of selling of diamonds in consumer markets.

Let me show you exactly how De Beers has moved ahead of the game:

The reality is that diamonds from De Beers are just like diamonds from the rest of the industry. **However, it is the only one making noise about its diamonds in consumer markets.** The company is telling consumers how hard it works to excel...how hard it works to present diamonds in the best possible way.

De Beers Using Forevermark to Reclaim Control of Diamond Industry Pipeline?

Most retailers in the industry use similar selling points to consumers...except for Forevermark.

Forevermark is citing facts about its diamonds that other diamond sellers are not citing. This is how it has outmanoeuvred the competition.

Consumers do not normally differentiate between grading laboratories but De Beers' marketing efforts are gradually changing the game. The Forevemark marketing message is resonating with an increasing number of industry players and connecting with consumers in both established and emerging markets for diamonds.

De Beers is telling consumers that diamonds that pass through its grading institute are the best in the world - responsibly sourced, rare and beautiful.

"Inscribed, responsibly sourced, 1 percent"

"Inscribed" - Forevermark retailers are showing the inscription (branding) to customers. A powerful message that this diamond is really what they say it is

"Responsibly Sourced" - for ethically inclined consumers

"Top 1 percent of diamonds" - for those who want nothing but the very best

The crucial thing is that De Beers does not have to do a lot of selling in the pipeline. Nor does it have to fight the other grading labs directly.

If consumers demand Forevermark, the manufacturers will polish more diamonds for the Forevermark pipeline, the Forevermark Institute will grade more diamonds and retailers will supply the demand.

I trash De Beers on its other branding efforts, which I think are useless for growth of diamond consumption. However, De Beers is on point with its strategy for Forevermark.

All the results depend on the consumer - all your wholesale demand and all your retail demand. I believe the Forevermark proposition is so strong that it will eventually move the mass millions. The rapidly expanding retail network tells you it is working out as planned.

De Beers Using Forevermark to Reclaim Control of Diamond Industry Pipeline?

In the final analysis, there is nothing special about Forevermark's methods. Anyone in the industry can imitate them. However, Forevermark, with the powerful backing of its parent, is simply the first to tell certain convincing facts. And that is an example of dominant competitive positioning.

The way I see it, the grading labs are not going away any time soon. However they could move to the background and begin specializing in grading and inscribing diamonds for private label diamond brands - Russiamark, Canadamark, Lesothomark, Chowtaifookmark, Zimba....ok, I am sure you get the idea.

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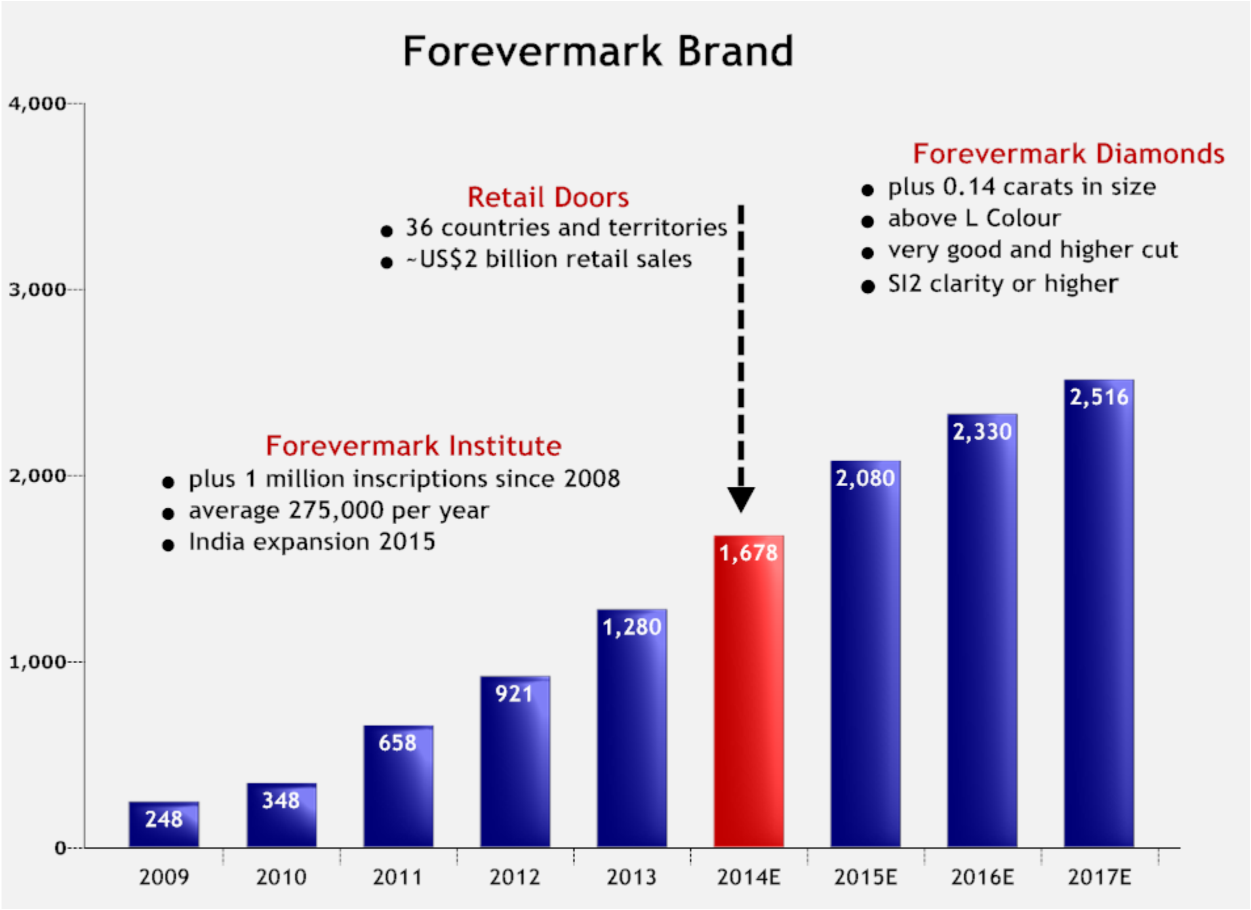
A Short Introduction to Forevermark

Exhibit 10



Source: Equity Communications research

De **Beers created the Forevermark brand to capture the best of each stage of the diamond industry value chain. However, Forevermark is actually the old De Beers reborn.**

The diamond industry giant is gradually reclaiming control of the diamond pipeline, starting with the path taken by diamonds from its mines until they reach the point of sale in retail markets. More importantly, there are pipeline players freely collaborating with De Beers in its effort to achieve this. That is very powerful.

Forevermark diamonds are natural, untreated, not from areas of conflict, consistent with the best environment practices and social behaviour and are thus ethically sound. In essence, Forevermark stands for the integrity of the diamond. It is not linked to the quality and value of the diamond measured by the traditional four Cs. **Forevermark represents the fifth C - Confidence - hence the 5Cs model.**

De Beers Using Forevermark to Reclaim Control of Diamond Industry Pipeline?

Forevermark Pipeline

Stage 1:

De Beers says less than one percent of the world's diamonds are eligible to become a Forevermark diamond. According to 2013 research data by Equity Communications, an estimated ninety-percent of Forevermark diamonds come from De Beers owned mines.

Stage 2:

Leaning on the strength of its global sightholder system, De Beers urges selected manufacturers (Forevermark Diamantaires) to produce high quality polished diamonds suitable for the Forevermark pipeline. These diamonds are brought back to De Beers to be graded at the Forevermark Diamond Institute in Antwerp, which issues a passport-sized report. Manufacturers pay the normal certification fee.

De Beers then provides a Forevermark Diamond Grading Report, featuring the unique identification number inscribed on the diamond and a specifically designed security hologram, providing reassurance that the Forevermark Diamond Grading Report is valid and genuine.

---Bridge---

In 2012, De Beers' Forevermark launched FMX, an online trading platform for its partners to buy and sell Forevermark diamonds. This platform provides the backbone for the Forevermark pipeline and is only accessible to those companies - traders, manufacturers and jewellers - that are part of the Forevermark system. FMX allows authorized suppliers to upload details directly and elect to have their diamonds appear online automatically, within a few hours or less of when they are graded by the Forevermark Diamond Institute.

Stage 3:

De Beers encourages pre-selected retailers to become Forevermark Jewellers. Forevermark Jewellers sell the branded diamonds to consumers. The license fee is $10, 000 per store or $25, 000 per Forevermark vendor. The sweetener is that De Beers handles all marketing for the Forevermark brand, using its substantial financial resources and considerable diamond marketing expertise.

Analysis

The Forevermark ecosystem is a win-win for everyone involved.

1. De Beers (central supplier)

Key Competitive advantage: De Beers gets to control distribution and placement of its top quality diamonds.

DeBeers is aggressively inscribing its diamonds so that jewellers can easily identify diamonds sourced through the official De Beers network.

The more Forevermark-licensed jewellers there are out there, the greater the strain on De Beers already limited high quality production. If the assumption is that consumer demand for expensive high quality diamonds is strong and growing, the end of it all is that De Beers will sell its top diamonds at a higher price. These diamonds are already a significant component of De Beers' total production by value.

Top end retailers who are not a part of the Forevermark system may eventually lose their ability to access high quality diamonds from the De Beers production system.

Furthermore, the requirement for ethically sourced diamonds has gained momentum in heavyweight markets like the USA. In this context, Forevermark branded diamonds give De Beers' diamonds protection against reputational risks associated with conflict diamonds.

In theory, De Beers can now trace all of its gem diamond production from mine to store. That could still happen in the coming decades. Thus far, De Beers has chosen to concentrate its branding effort at the top end of the market.

Starting branding initiatives at the top end makes sense because consumers in this segment are less price conscious and decidedly more brand focused. There already exists a market for Tiffany branded diamonds, routinely sold at a premium to other diamonds of the same specifications.

2. Forevermark Diamantaires (manufacturers)

Key Competitive advantage: Forevermark manufacturers gain lucrative pre-qualified retail clients.

Forevermark manufacturers have the freedom to produce polished diamonds as they please - as stones or finished pieces, relying on collaborative research with De Beers on popular trends in consumer markets.

Furthermore, these manufacturers can become exclusive suppliers to a consumer region. For example, Crossworks Manufacturing Limited is the only licensed supplier for participating retailers in the United Kingdom and Ireland.

The way I see it, it is quite possible that the majority of all high quality diamonds will eventually end up being Forevermark diamonds. De Beers' strongest manufacturers are also clients of the leading diamond producers like Dominion, Alrosa and Rio Tinto. If it is true that participation in Forevemark's pipeline results in greater profitability for manufacturers then it is likely that these manufacturers will switch an increasing proportion of their high quality production to Forevermark...that is if De Beers' marketing initiatives manage to grow retail demand for Forevermark-inscribed jewellery

3. Forevermark Jewellers (retailers)

Key Competitive Advantage: Forevermark retailers do not have to spend a fortune to market branded diamonds.

The diamond industry has bemoaned the lack of generic marketing of diamonds in consumer markets. Generic marketing of diamonds was the responsibility of De Beers when it exclusively sold much of the world’s annual production of diamonds. Times have changed; it is a different world today.

However, what is clear is that the absence of generic marketing has slowed the growth of diamond markets. Retailers operating in the targeted segment may find it to their advantage to join the Forevermark system if it means shifting some of the marketing costs to someone else.

De Beers Using Forevermark to Reclaim Control of Diamond Industry Pipeline?

Forevermark retailers have a high degree of freedom to display the Forevermark as they wish and one could use the association to drive store traffic. For example, Forevermark's Center of My Universe campaign appears to have done extremely well in the United States market.

Thus far, the Forevermark brand has focused its marketing efforts on diamond products that are generally resilient in periods of weak demand - bridal jewellery and diamond stud earrings. The target market is the luxury-focused consumer with an annual income of at least US$70,000, in the market for large size high quality diamonds. Incidentally, this is the most popular segment in the top market of USA where Forevermark has targeted 750 retail doors as quickly as possible.

Forevermark has not yet reached tipping point. This may happen within five years if volume growth continues at current pace. Success depends on consumers.

If more consumers are induced to demand Forevermark diamonds, more retailers will obtain them. If the retailers want them, the polished diamond wholesalers will supply them. If the polished diamond wholesalers want more rough diamonds to manufacture for the Forevermark pipeline, rough diamond producers will divert more rough diamonds to the Forevermark pipeline.

It will be interesting to see how the rest of the industry responds in the coming years. **Forevermark represents competition for just about every other diamond company in the diamond industry value chain - other producers, rough diamond traders, polished diamond wholesalers, trading platforms, grading labs, jewellery manufacturers and retailers.**

4. Lab-Created Diamonds A Form Of Terrorism On Diamond Trade?

Lab-created diamonds a form of terrorism on diamond trade?

De Beers has estimated total synthetics production capacity by combining publicly available information about the number and type of machines used by the main synthetics producers with the practical experience of Element Six Technologies (a leader in synthetic diamond production for technical applications, wholly owned by De Beers) in using such technology.

If all known CVD reactors capable of producing gems were used solely for synthetic gem production, the company estimates that annual production would be around 150,000 polished carats. HPHT production of colourless and near-colourless synthetics is estimated at below 10,000 carats.

In reality, however, most of the available capacity is used for industrial purposes, not for gem-quality production**. Based on disclosed volumes, known cases of undisclosed synthetics and initial feedback from users of the AMS machines, the company estimates that production of gem-grade synthetics is in the range of 15,000-60,000 carats per year.** The majority of these carats are produced by two or three companies based in South East Asia and North America.

Overall, the volume of gem-quality synthetics produced by either CVD or HPHT processes is estimated to still be low.

Despite these low volumes, the diamond industry must remain vigilant about the persistent risk of undisclosed synthetics. To date, through technological innovation, the industry has been successful in safeguarding consumer confidence. Continual investment in developing and deploying technology will be required to sustain that success in future.

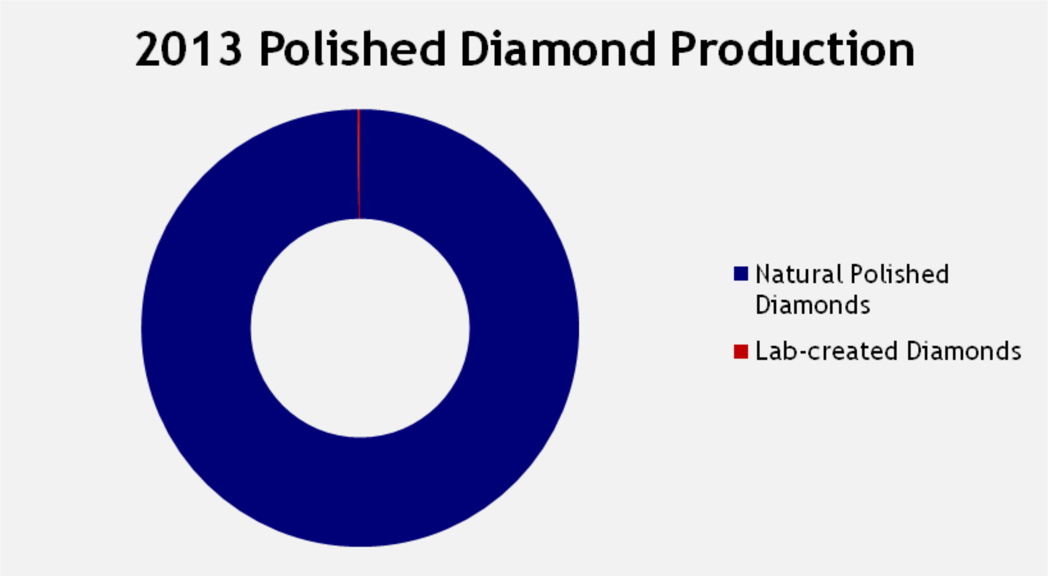
De Beers, drawing on a co-ordinated effort between its Global Sightholder Sales and Technologies divisions, and the International Institute of Diamond Grading and Research (IIDGR), built a compact, portable automated machine, the Automatic Melée Screening (AMS) device, to scan both colourless and near-colourless melée quickly and cost-effectively. The AMS machine was piloted in Antwerp in mid-2013 and is now being sold to De Beers' Sightholders, helping to maintain confidence across the industry. The first 100 AMS machines were produced and available for shipment to the Sightholder community less than 12 months after the issue first surfaced. By the end of July 2014, orders for 60 AMS machines had been received, with installation and training having been completed for 25 of these units.

Source: De Beers' Diamond Insight Report, September 2014

Lab-created diamonds a form of terrorism on diamond trade?

Comment

Exhibit 11



Source: Equity Communications

Less than 0.2 percent of all polished diamonds produced in a single year are lab-created.

Therefore, the more insidious problem for the diamond industry is that **fraudulent distribution of lab-created diamonds is a form of terrorism on diamond trade.**

If there are people in the diamond pipeline who are willing to exploit the improving technology of lab-created diamonds so that they misrepresent them as natural occurring diamonds, then the whole diamond industry must remain on permanent lockdown.

However being on permanent lockdown adds costs and reduces profitability for honest pipeline participants.

For instance because of the recent scares, it could mean having to rent one of those diamond screening machines from De Beers at an annual cost of US$25,000 just to stay safe. Alternatively, it could mean having to start certifying diamonds that you normally would not because the added cost has previously been prohibitive.

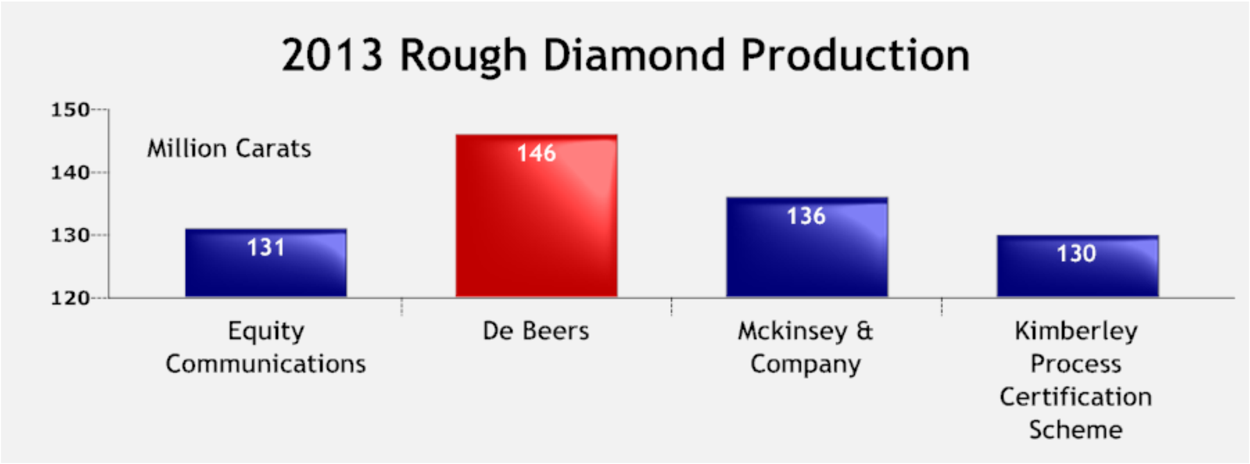
Lab-created diamonds a form of terrorism on diamond trade?

Henceforth, our view is that it will become more difficult to misrepresent lab-created diamonds as natural diamonds in the greater diamond industry pipeline. The clear winners in this latest round of exposures are the grading labs and manufacturers of screening machines that get windfall business.

5. De Beers' Data On Global Diamond Production And Sales Questionable?

De Beers' Data on Global Diamond Production and Sales Questionable?

Exhibit 12



Source: Equity Communications

De Beers estimates that overall global rough diamond production **increased by seven percent from 2012 to reach 146 million carats in 2013**. These estimates are unusually high and questionable.

According to De Beers, the largest diamond producing country by volume is Russia, which in 2013 produced 25 percent of total carats.

Russia was followed by DRC, which produced 28 million carats. However, Kimberley Process Statistics show that DRC produced 16 million carats in 2013. **De Beers likely overestimated production of diamonds from DRC by 75 percent.**

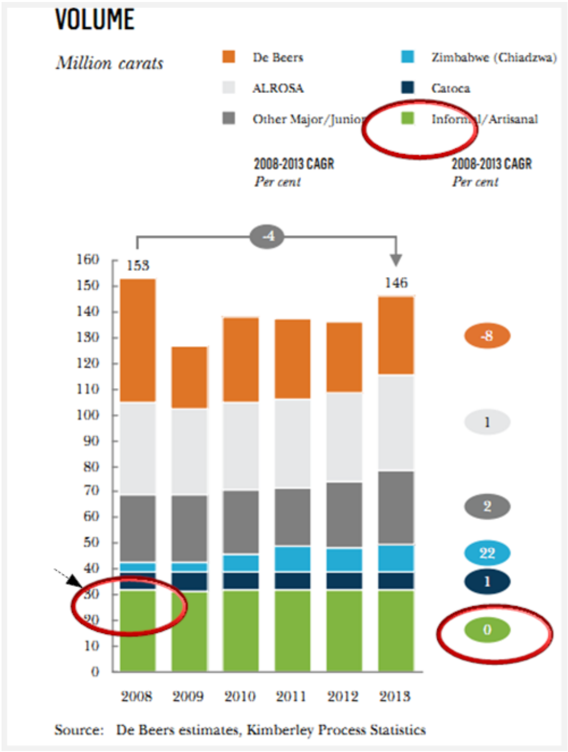
(The Kimberley Process tracks and annually publishes rough diamond production data of all diamond producing countries. It also tracks and publishes import and export data of all rough diamonds traded in international markets. Data from the Kimberley Process has become extremely authoritative.)

Please continue to next page...

De Beers' Data on Global Diamond Production and Sales Questionable?

Furthermore, if you look closely at the global diamond production chart provided in the Diamond Insight Report, you will notice De Beers suggests the informal/artisanal group has produced a constant 32 million carats of diamonds annually since 2008.

Exhibit 13



Source: De Beers' Diamond Insight Report, September 2014, Equity Communications edits

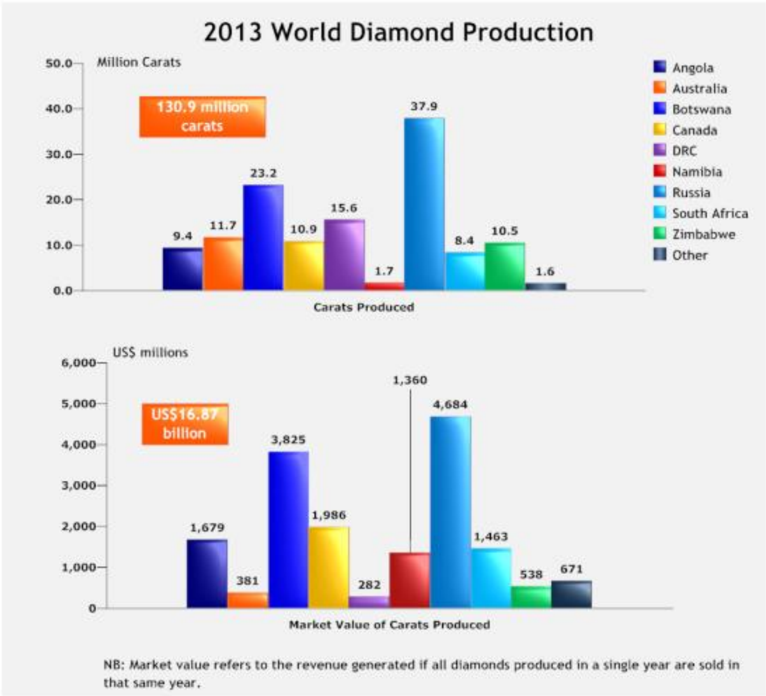
Frankly, the figure has become too high. Just two producer countries have informal miners that produce more than a million carats of diamonds annually:

- Artisanal miners in Angola produce less than 3 million carats annually
- Producers from DRC - probably included in the artisanal/informal group - actually produced an average of 19.6 million carats from 2009 to 2013, according to Kimberley Process Statistics.

De Beers' Data on Global Diamond Production and Sales Questionable?

Essentially, **nine countries** - Angola, Australia, Botswana, Canada, DRC, Namibia, Russia, South Africa, and Zimbabwe - **accounted for more than 98 percent of diamonds produced in 2013.** This figure includes artisanal miners in both DRC and Angola. No other major producer country has impactful contribution from informal miners.

Exhibit 14



Source: Global Diamond Business 2014 report – Equity Communications, August 2014

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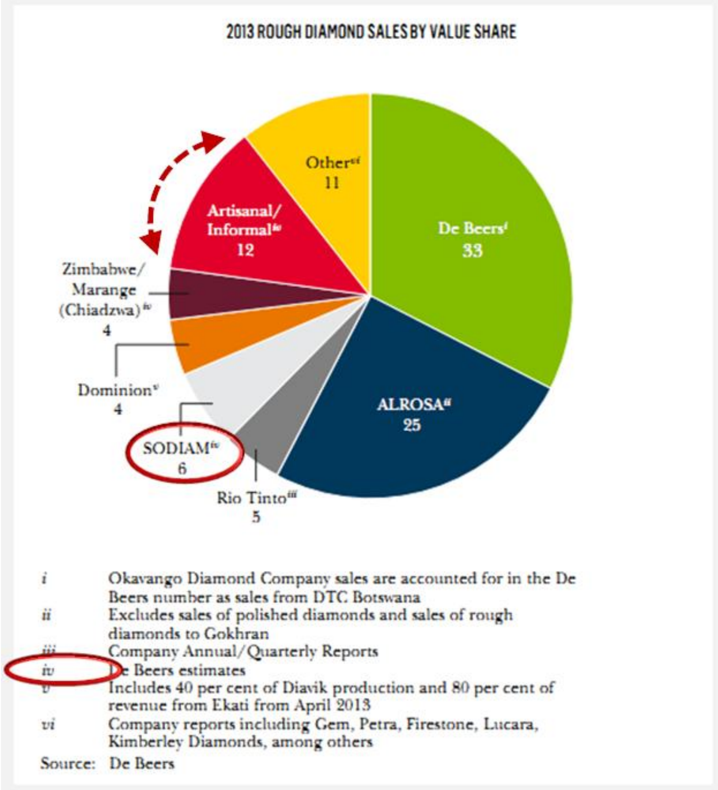
De Beers' Data on Global Diamond Production and Sales Questionable?

De Beers also suggests **informal miners sold rough diamonds worth US$2.2 billion in 2013.** This figure excludes informal miners from Angola whose production is sold through Sodiam, represented separately in the chart provided by De Beers.

Exhibit 15



Source: De Beers' Diamond Insight Report, September 2014, Equity Communications edits

I believe it is fair to ask that De Beers provide more information on the identity and location of these informal miners, which are the third largest sellers of rough diamonds measured by value. It is certainly not DRC because the country exported rough diamonds valued at US$231 million in 2013.

Please continue to next page...

De Beers' Data on Global Diamond Production and Sales Questionable?

Exhibit 16

2013 Rough Diamond Production (mln carats)	De Beers Data	Market Share	Equity Communications Data	Market Share
Alrosa	37	25%	37	28%
De Beers	31	21%	31	24%
Rio Tinto	16	11%	16	12%
Catoca	7	5%	7	5%
Zimbabwe (Marange)	12	8%	10	8%
Other	43	29%	30	23%
	146	100%	131	100%

2013 Rough Diamond Sales (US$ Billions)	De Beers Data	Market Share	Equity Communications Data	Market Share
Alrosa	4.5	25%	4.9	29%
De Beers	5.9	33%	5.8	35%
Rio Tinto	0.9	5%	0.9	5%
Sodiam (Angola)	1.1	6%	2.2	13%
Dominion	0.7	4%	0.8	5%
Zimbabwe Marange	0.7	4%	0.4	2%
Artisanal/Informal	2.2	12%	N/a	N/a
Other	2	11%	1.8	11%
	18	100%	16.8	100%

Source: De Beers' Diamond Insight Report 2014, Equity Communications' Global Diamond Business 2014

On balance, De Beers data on global diamond production and sales grossly distorts the dynamics of the rough diamond market, which is dominated by the so-called 'big three' producers. The influence of informal diamond miners is made to appear much stronger than it actually is.

Perhaps next time De Beers will provide detailed tabular data to accompany its charts. That would be most helpful.

6. Diamond Demand To Outpace Supply?

LOOKING AHEAD

DIAMOND PRODUCTION IS EXPECTED TO FALL GRADUALLY WHILE OPERATING COSTS WILL CONTINUE TO INCREASE.

Overall diamond supply is expected to increase in the next few years, driven by new projects coming on stream. By 2020, when many of the existing mines will begin to see declining outputs, overall supply is expected to plateau (see Fig. 27).

A number of projects are under way to expand diamond production. By 2020, about 25 per cent of carat production will come from projects currently under development, but much of this increase in output comes from projected expansion at current mines such as Rio Tinto's Argyle mine in Australia.

Among new developments, the largest are ALROSA's Botuobinskaya, Lukoil's Grib and De Beers'/Mountain Province Diamonds' Gahcho Kué projects. Beyond 2020, there is a risk that production levels will begin to decline unless major new discoveries are made in the coming years and rapidly developed. As illustrated elsewhere in this report (see 'Diamond Exploration' chapter), the likelihood of large economically viable discoveries is low, and so supply can be expected to decline gradually after 2020.

In order to make a difference to global availability, any discovery would have to be substantial – even the largest of new projects under development, Gahcho Kué, will only expect to add approximately five million carats per year at its peak of production, about three to four per cent of annual global production (see Fig. 28).

Even if new discoveries were made, the impact of such discoveries on production levels would be likely to be slow. From 1950 to today, it took an average of 14 years between the discovery of a diamond deposit and the start of production. For projects currently in development, however, this time is even longer: it will take more than 20 years from discovery to first production. Gahcho Kué, for example, was discovered in 1995, but is not projected to enter production until late 2016.

Diamond production is also becoming increasingly challenging as mining moves towards deeper, less profitable and more remote sources. This trend is explored further in the 'In Focus' section, 'The miracle of production'.

Diamond Demand to Outpace Supply?

Comment

This is where Equity Communications differs with many diamond industry analysts out there. **In our opinion, there is too much misplaced focus on the coming supply crunch. It really is not as impressive as it sounds.**

Ok, let me also overlook the next five years of surplus production and focus on the post 2020 period. It is what is fashionable.

This is what is on the horizon - ten years to 2025

Mines on way out:

- Many of the world's premier diamond mines - turning out at least 5 million carats of diamonds over many decades - are now past their peak production levels, with operators having to go deeper to recover diamonds. Deeper operations mean lower mining grades and higher costs for operators.

- There are no new premier diamond mines on the horizon.

- Two premier diamond mines are likely to exhaust supply within the next ten years. The Argyle mine in Australia has produced more than 800 million carats of diamonds since 1983. It could exhaust supply around 2021. The Diavik mine in Canada has produced more than 80 million carats of diamonds since 2003. It could close around 2023. Both mines are operated by Rio Tinto.

- A third large mine, Ekati in Canada, will come to the end of its life in 2019. Ekati has produced more than 55 million carats of high quality diamonds since 1999.

- A small mine, Ellendale in Australia, is producing diamonds at the end of its stretched economic life. Ellendale is the world's leading source of rare fancy yellow diamonds and contributes an estimated 50 percent of the world supply. Fancy yellow diamonds from Ellendale are sold to Tiffany and Co under a Life of Mine off-take agreement.

Replacement projects in pipeline:

Referencing Fig 28: Diamond Project Pipeline (2014-2017) from De Beer's Insight Report...**let us assume that these projects are of a permanent nature...that is at least ten years of annual production**

Exhibit 17

Incoming Diamond Mines
Using De Beers' Table Of Diamond Projects In Pipeline

Deposit Name	Location	Est. First Production	Average Annual Production (mln carats)
Grib	Russia	2014	4
Botuobinskaya	Russia	2015	2
Karpinsky 1	Russia	2015	1
Gahcho Kue	Canada	2016	5
Renard	Canada	2017	2
Star Orion South	Canada	2018	2
Bunder	India	2019	2
Ghaghoo	Botswana	2014	0.4
Other	Global Combined	2016	4
Total			22.4

Source: De Beers' Diamond Insight Report, Equity Communications

The above projects will eventually add **22.4 million carats** to annual global supply of diamonds beyond 2025, prudently forecasting

Please continue to next page...

Diamond Demand to Outpace Supply?

Let us now add existing diamond projects that are being permanently expanded by at least 1 million carats annually:

Exhibit 18

Expansion of Producing Diamond Mines (at least 1 million carats)		
	Location	Average Annual Production Added
Alrosa's Portfolio (undergound)	Russia	4
Cullinan	South Africa	1
Liqhobong	Lesotho	1
Arkhangelsk	Russia	2
Marange	Zimbabwe	4
Debswana (capacity)	Botswana	3
Catoca	Angola	2
Other	Global Combined	2
Total		19

Source: Equity Communications

The above expansion projects will add at least **19 million carats** to annual global supply of diamonds until at least 2025, prudently forecasting.

Now let us add the above projections to 2013 Global Diamond Production

Exhibit 19

Global Diamond Production in 2025 (Including Mines On Way Out)	
	Million Carats
Diamond Production 2013	130.9
Pipeline Projects	22.4
Expansion Projects	19
Total	172.3

Source: Equity Communications

130.9+22.4+19 = 172.3 million carats

Lastly, let us remove the contribution of mines that will likely no longer exist in 2025 from this total, using 2013 production figures.

Exhibit 20

Diamond Mines on Way Out - Using 2013 Production		
	Location	2013 Production (mln carats)
Ekati	Canada	1.9
Diavik	Canada	7.2
Argyle	Australia	11.4
Other	Global Combined	8
		28.5

Source: Equity Communications

Therefore, Global Diamond Production in 2025

Exhibit 21

Forecast Global Diamond Production in 2025	
	Million Carats
Diamond Production 2013	130.9
Pipeline Projects	22.4
Expansion Projects	19
Sub Total	**172.3**
Subtract	
Mines on way out	**28.5**
Global Diamond Production 2025	**143.8**

Source: Equity Communications Esimates

Therefore, **we can reasonably expect global diamond production of diamonds to be around 144 million carats in 2025.** Or about 10 percent higher than current production levels, using Equity Communications data and Kimberley Process statistics.

Diamond Demand to Outpace Supply?

Here is where it gets interesting...

Not all diamond producing regions are equal. Diamonds from some regions are more important to jewellery markets while diamonds from other regions are less important.

Take a look at the following tables:

Exhibit 22

Classification of Producer Countries
Average market value of production footprint

Group 1 0-100 US$/carat	Group 2 101-400 US$/carat	Group 3 401+ US$/carat
Australia	Angola	Lesotho
China	Botswana	Liberia
DRC and Congo	Brazil	Namibia
Ghana	Canada	
Zimbabwe	Central Africa Republic	
	Guinea	
	Guyana	
	India	
	Russia	
	South Africa	
	Sierra Leonne	
	Tanzania	
	Togo	

Source: Equity Communications, KPCS

Source: Global Diamond Business 2014 report – Equity Communications, August 2014

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Exhibit 23

Marketshare of Producer Group 2013

Production

	2008	2009	2010	2011	2012	2013
Group 1	30.74%	30.98%	30.96%	30.60%	33.79%	29.07%
Group 2	67.58%	67.90%	67.62%	68.19%	64.53%	69.28%
Group 3	1.68%	1.11%	1.42%	1.20%	1.69%	1.65%

Value

	2008	2009	2010	2011	2012	2013
Group 1	9.07%	7.07%	8.05%	6.98%	7.44%	5.54%
Group 2	82.16%	86.70%	83.68%	85.61%	85.53%	88.42%
Group 3	8.77%	6.24%	8.26%	7.41%	7.04%	6.04%

Source: Equity Communications, KPCS

Source: Global Diamond Business 2014 report – Equity Communications, August 2014

- Group 1 countries produce the fewest pure gem quality diamonds. They mainly produce industrial diamonds and near-gem quality diamonds destined for fashion jewellery markets

- Group 2 countries produce the largest number of commercial grade diamonds mainly destined for love markets all over the world but mostly to USA, Japan, India and Greater China

- Group 3 countries produce a relatively high number of premium quality diamonds – top quality white diamonds and rare large size diamonds - mainly destined for luxury consumer markets

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Diamond Demand to Outpace Supply?

The world is at risk of losing diamond production from Group One countries. All indications are that Australia will not be a major diamond producer in 2025 after the Argyle Mine exhausts production.

The production outlook for Zimbabwe and DRC is less certain because of well-documented problems in the two countries. Therefore production from both countries could either decrease or increase, depending on the operating environment going forward.

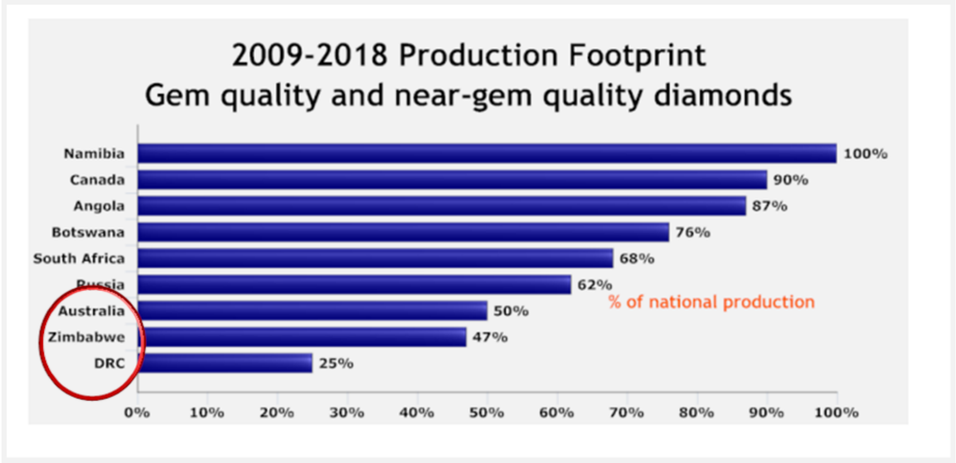
The other countries in the group are not relevant at the global level.

More importantly, I hope you are now beginning to understand why the coming supply crunch is not as impressive as it sounds. **The world is going to lose substantial production but from the least important group for diamond jewellery.**

That is one side of the story.

Equity Communications ranked diamond producing countries by quality of the production footprint for the period 2009-2018.

Exhibit 24



Source: Global Diamond Business 2014 report – Equity Communications, August 2014

Note: After mined ore is processed, the diamonds produced are sorted according to the following general categories: gem-quality, near-gem quality, and industrial. Nowadays gem quality and near-gem diamonds refers to any diamonds suitable for use in jewellery.

Diamond Demand to Outpace Supply?

The other side of the story is that replacement projects have a higher footprint of diamonds suitable for use in diamond jewellery. What we are losing in absolute quantity we are making up for it in absolute quality.

Exhibit 25

Global Diamond Production 2013 versus 2025

Million Carats	2013	2025	Movement
Group 1	38	29	-9
Group 2	**90**	**113**	**23**
Group 3	3	2	-1
	131	144	13

Market Share	2013	2025	Movement
Group 1	29%	20%	-9%
Group 2	**69%**	**79%**	**10%**
Group 3	2%	1%	-1%

Source: Equity Communications

In the final analysis, the world will likely lose supply of diamonds destined for fashion jewellery markets. However, diamond producers are also going to add considerably to the supply of diamonds destined for love markets - the core market for diamonds. This will probably sufficiently cater for the expected increase in consumer demand for such diamonds. In other words, the coming supply crunch will mostly affect the less valuable segment of the global market for diamonds.

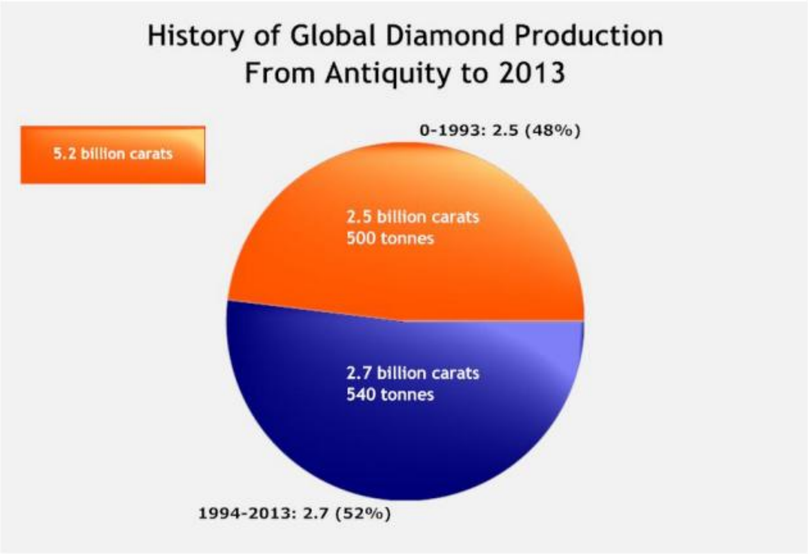
Do not get it twisted though; supply from Australia is potentially irreplaceable even though it probably won't affect the wider consumer market. In less than ten years, there will be fewer diamonds available for the low end of diamond jewellery markets and fewer diamonds available for the coloured diamonds market. With Argyle out of the picture, the average value of diamonds recovered per year will also rise to reflect new world supply realities.

7. Are We Running Out Of Diamonds?

Are We Running Out of Diamonds?

2.7 billion carats of diamonds have been dug up from the Earth's surface since 1994. **That is to say, more diamonds have been mined in the last 20 years than in all of history.**

Exhibit 26



Source: Global Diamond Business 2014 report – Equity Communications, August 2014

Still, the world's appetite for these beautiful gems has never been stronger.

And now, diamond producers have to go deeper and deeper into the earth's surface in their quest to satisfy our never ending desire for these sparkling stones.

However, diamonds are a natural resource with exhaustible supply. Therefore, there are valid questions to be asked about the current rate at which the world is mining diamonds. For instance:

- At the rate we are going, won't we soon dig up all the known diamond reserves from the Earth's surface?
- Should we slow down the rate at which we are digging up these gems and will there be any diamonds left for future generations?

Are We Running Out of Diamonds?

Make no mistake about it, 2.7 billion carats mined in just twenty years is a lot of diamonds…but the answer is still somewhere between yes and no.

If you are talking 10 years, the answer is no. If you are talking 20 years, the answer is still no. However, if you are talking 30 years, the answer **right now** is probably YES!

Why the emphasis on right now?

Well, it is because the situation is dynamic…it changes all the time.

Let me show you exactly how this works:

After discovery of a diamond deposit, mining companies usually split it into two - **Mineral Resources and Mineral Reserves.**

Basically, Mineral Resources are the global measurement of the deposit - the entire supply of diamonds available in it and inclusive of those which a mining company is not sure yet whether they can be mined profitably at current prices.

Conversely, Mineral Reserves are the measured part of the deposit with diamonds that can be mined profitably at current prices.

As a rule, mining companies prudently use low estimations for the Mineral Reserve. It is just good business. However, these estimations are often upgraded once economic viability is demonstrated for diamonds placed in the global Mineral Resource.

In general, **large diamond deposits can be mined for a period of 30 years up to 100 years.** Diamond producers often discover additional ore reserves while the mine is in operation and usually extend its life. Furthermore, technological innovation and higher diamond prices often improve economic viability of previously unprofitable parts of the deposit.

For example, the Cullinan mine in South Africa has been in production on and off for more than a hundred years. According to Petra Diamonds, Cullinan's current mine plan has a life of 16 years. Nevertheless, the actual Life of Mine (LOM) could be in excess of 50 years since Cullinan contains a diamond resource of 200 million carats of which less than 2 million carats are currently produced per year.

Here is another example but this time using a selection from Alrosa's portfolio of diamond mining operations. Alrosa has a humungous diamond resource base in its portfolio that can be mined at current levels for at least another thirty years.

Exhibit 27

Alrosa's Diamond Portfolio (Sample)

Diamond Pipe	Mining Method	Commissioned	Current Depth	Boundary of Indicated Resources	Boundary of Inferred Resources
Jubilee Pipe	Open-pit	1985	**-340**	-720	-1100
Aikhal Pipe	Underground	2005	**-305**	-500	-700
	Open pit	1961-1996	**-305**		
International Pipe	Underground	1999	**n/a**	-1085	-1215
	Open pit	1971-1981	**-315**		
Udachnaya Pipe	Open pit mining	1971	**-640**	-890	-1390

Source: Equity Communications, Alrosa

When I look at the supply and demand fundamentals for diamonds, I am convinced that **it will likely be business as usual for the diamond industry until at least 2030, as has been the case for at least the past hundred years.**

That is, the requirement for careful management of diamond supply by producers so that it does not rise faster than demand.

Please continue to next page...

Are We Running Out of Diamonds?

With this in mind, a lot of diamonds have been produced in the last twenty years…

However, diamond miners have also added substantially to global reserves of economically exploitable diamond ore.

We have not had any new major discoveries of diamond deposits for a long time now. **Nevertheless, there are collectively significant new diamonds mining projects now at the advanced development stage. If we combine the expected output from these pipeline projects we get the equivalent of two or three premier diamond mines. Perhaps even more significant, diamond exploration has focused on the development of diamond deposits that have a higher footprint of gem quality diamonds.**

Generally, diamond value and grade are the dominant factors that influence the decision to proceed with mine development. Therefore, the current cycle of production increases and new projects will carry a higher proportion of gem quality diamonds.

Fundamentally, diamond mining projects proceeding in Canada and Russia are singled out as being extremely positive for the world's annual supply of gem quality diamonds over the next five to twenty years.

Exhibit 28

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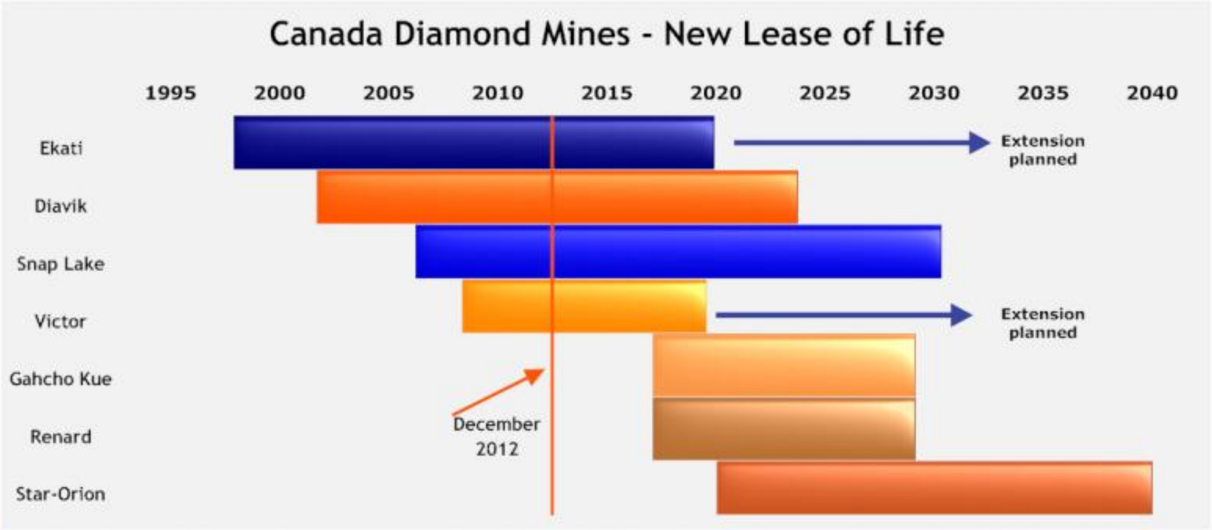
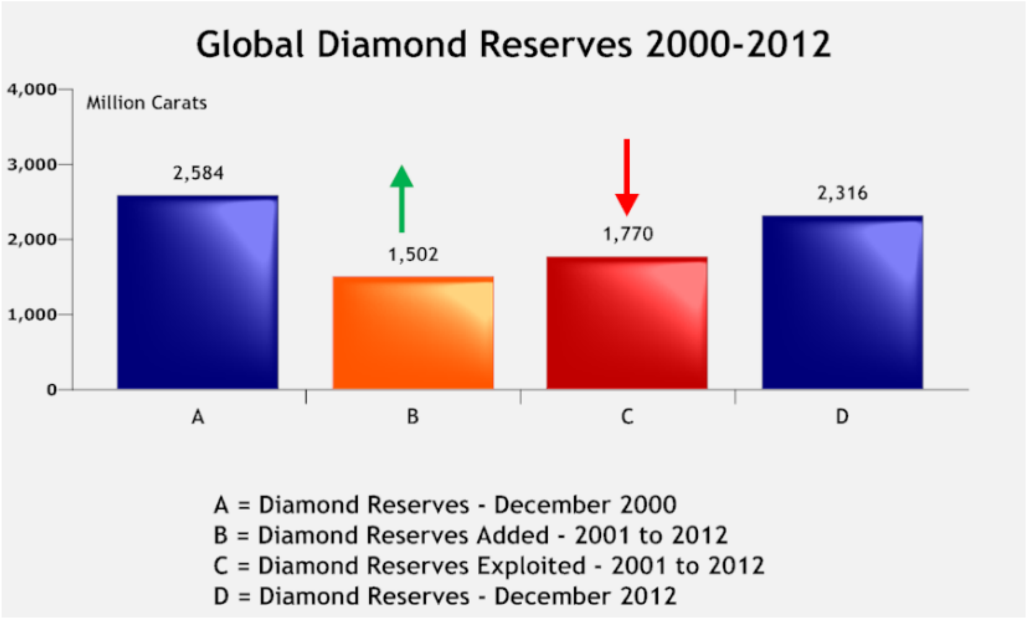


Source: Global Diamond Business 2014 report – Equity Communications, August 2014

Are We Running Out of Diamonds?

Here is a balance sheet of diamond mining from 2001 to 2012:

Exhibit 29



Source: Global Diamond Business 2014 report – Equity Communications, August 2014

As you can see, in those twelve years, global reserves of economically exploitable diamond ore were ultimately reduced by just 268 million carats - equivalent to diamond production for two years.

Matter of fact, the total level of global diamond reserves has remained stable in recent years - at 2.3 billion carats. That means annual production has roughly offset additions to reserves. This has happened because diamond miners reduced production in response to weak consumer demand because of the Global Economic Crisis.

De Beers, with Ernest Oppenheimer at the helm, correctly observed that supply and demand for diamonds requires careful management. For this reason, until the turn of the century, De Beers expertly controlled global diamond production to prevent an oversupply of diamonds. The former cartel would use its Central Selling Organization (CSO) to buy excess production from other producers for purposes of supply control in the diamond pipeline.

De Beers is no longer able to buy diamonds produced by other producers but the company is currently producing below capacity. That is another method of supply control. If there are too many diamonds in the pipeline, diamond prices can collapse.

In the final analysis, diamond miners have had sufficient reserves to sustain current annual production of diamonds for 18 years. That has not changed since 2010. However, with no new premier diamond projects in the pipeline, I am finding it harder to determine where production for the post 2030 period will come from. Anyway, 15 years into the future is a bit too far for me to be gazing into the crystal ball.

8. Polished Diamond Prices To Increase Faster In Future?

Diamond Industry Outlook

De Beers

Positive demand growth for diamonds will almost certainly outstrip growth in carat production in the next 10 years, given the lack of major new discoveries in the last decade and the projected production slowdown in several existing mines. Even under scenarios of volatile or weaker global economic growth, demand for diamonds is expected to show positive real growth in the next decade.

A positive supply demand outlook is shared by a number of external experts. For example, in its recent publication on the global diamond industry, McKinsey & Company sets out four potential future scenarios for the diamond industry. **In every scenario, demand growth outstrips production growth.** De Beers has undertaken some modelling of potential rough diamond supply and demand based on McKinsey's 'Diamonds are Forever' scenario, and the relative supply and demand curves are shown in Fig. 2. Other industry analysts have expressed similarly positive views.

'Diamonds are Forever' scenario

Consumer demand grows strongly, fuelled by recovery in the US economy and continued above-average growth in emerging markets, especially China and India. Brands become more important and increasingly invest in promoting the allure of diamonds. Even with demand in Europe and Japan softening, the dynamics of supply and demand in this scenario mean that previously uneconomical mining projects become economically viable, so production is maximised.

Source: De Beers' Diamond Insight Report, September 2014

Comment

Strictly speaking, diamond producers produce carats while consumers consume carats. Therefore, anyone who talks about diamond demand outstripping carat production must also provide data that shows carat consumption over time. Like for like.

Furthermore, diamond producers produce rough diamonds while consumers consume polished diamonds.

How many diamond industry experts actually provide hard data on polished diamond production by weight...and polished diamond consumption by weight?

To help prove my point...the World Gold Council measures supply and demand for gold in tonnes (weight). That is like for like. Similarly, Johnson and Matthey measures supply and demand for platinum in tonnes (weight). That is also like for like.

The tendency to extrapolate polished diamond consumption using rough diamond supply is just a reckless way of looking at diamond markets since the implication is that everything moves in a straight line.

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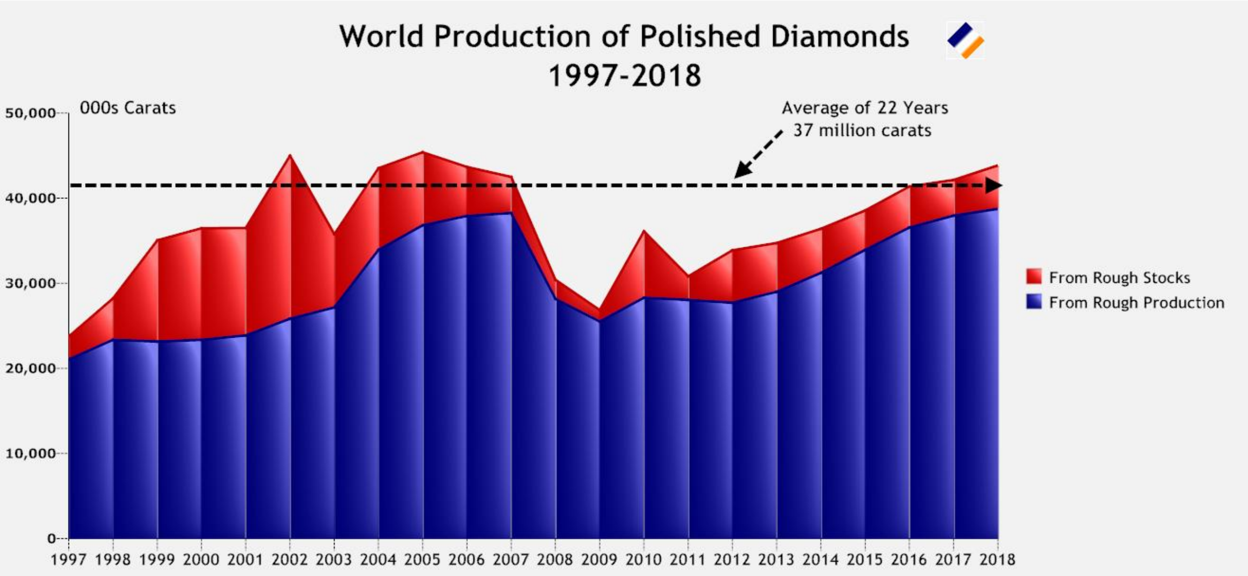
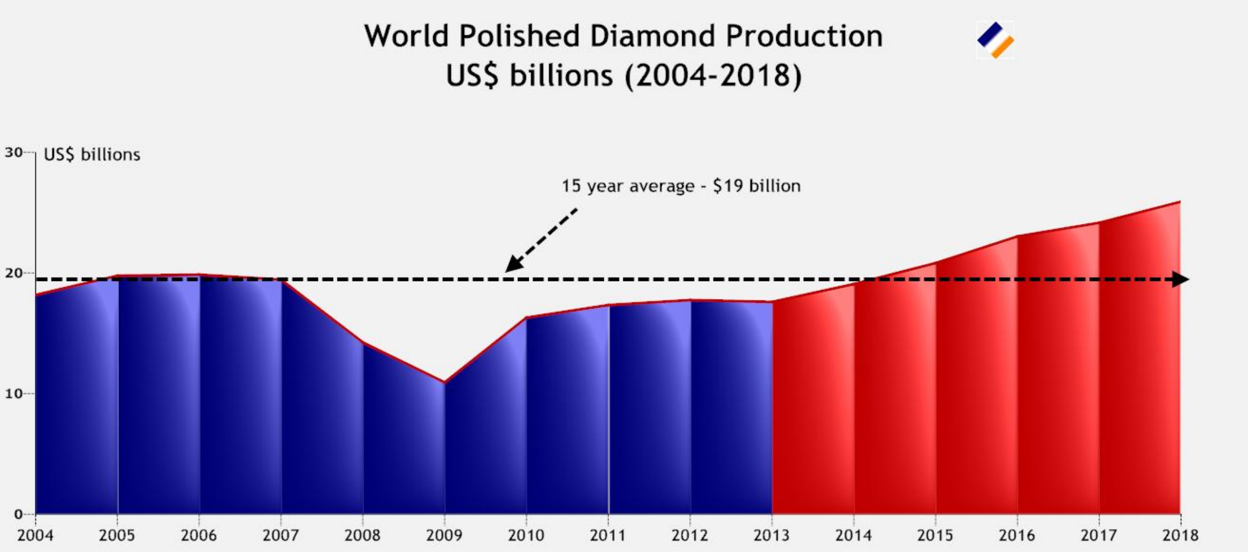
Polished Diamond Prices To Increase Faster In Future?

Exhibit 30



Source: Equity Communications

Exhibit 31



Source: Equity Communications

Anyway, I have said that the supply crunch is not as impressive as it sounds. The next five years will witness surplus supply for most types of diamonds. **This will add to global stocks of polished diamonds stored in the pipeline.** Global supply of diamonds will plateau sometime within the next decade. However, what we lose in quantity is being made up for in quality. These two events will offset each other for at least the next fifteen years.

To be sure, I am apositive on the demand outlook. Demand for diamonds will show positive real growth in the next decade. But I just do not agree with the obvious conclusion that this event will lead to a shortage of diamonds.

Have we not been trying to generate a global shortage of diamonds for the last hundred years or so? Despite what most people think, it is actually incredibly difficult to generate a global shortage of diamonds.

Harry Oppenheimer (Chairman of Anglo American Corporation and De Beers Consolidated Mines in 1971) showed great wisdom and understanding of diamond markets when he said, *"A degree of control is necessary for the well-being of the industry, not because production is excessive or demand is falling, but simply because wide fluctuations in price, which have, rightly or wrongly, been accepted as normal in the case of most raw materials, would be destructive of public confidence in the case of a pure luxury such as gem diamonds,* ***<u>of which large stocks are held in the form of jewellery by the general public.</u>****"*

Indeed, we must never take it for granted that there is minimal recycling of polished diamonds after consumers make purchases. Diamonds are marketed to consumers as symbols of love and devotion. By and large, consumers stick to the program and that is a good thing.

In all seriousness, the diamond industry actually does not afford any sustained shortage of diamonds even though many people salivate at the prospect. **A global shortage of polished diamonds would generate volatility...an 'evil' that can destroy the diamond dream.**

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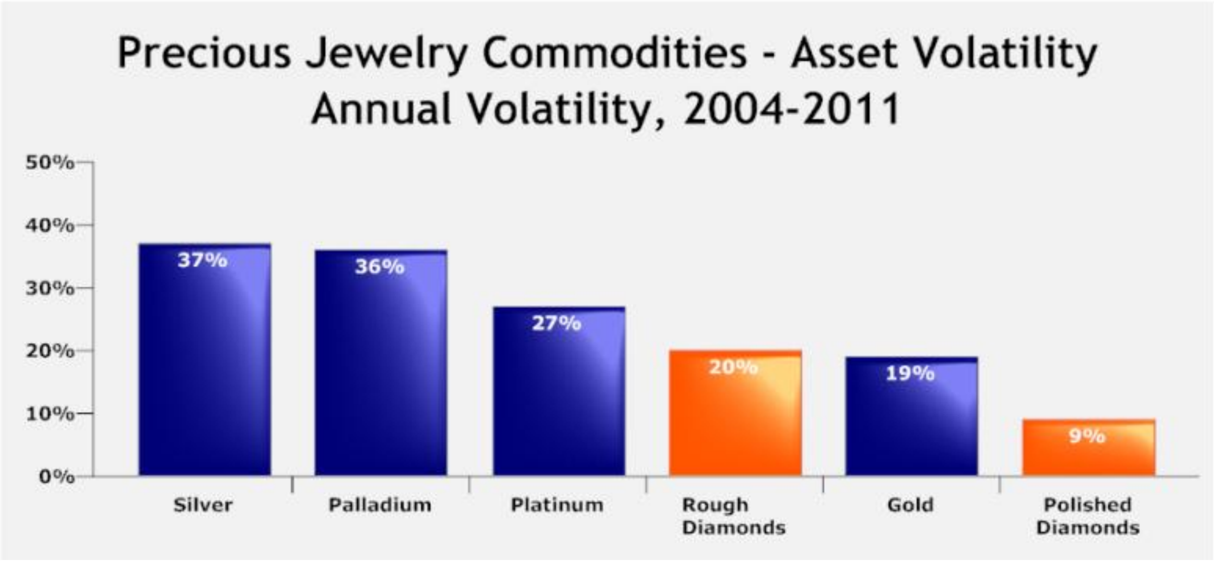
Polished Diamond Prices To Increase Faster In Future?

Exhibit 32



Source: Global Diamond Business 2014 report – Equity Communications, August 2014

Volatility is a term used to describe how much the value of an asset fluctuates over time. Volatile assets fluctuate in both directions. As a rule - the less volatile the asset, the less risky the investment. More volatile assets present more risk, but they also can present the higher reward possibility.

I am with Harry Oppenheimer on this one...

Huge swings either direction in the price of polished diamonds would introduce a new strong financial dynamic in the consumption of diamonds. Rough diamonds can afford large annually volatility because the market for rough diamonds is restricted to diamond traders.

Polished diamonds do not afford such large annual volatility and that is exactly what would happen if consumer demand for polished diamonds greatly outpaced supply.

In fact, there is a historical precedent:

The second half of the 1970s was a period of rapid inflation, during which many investors sought tangible assets as a hedge. Diamonds, on the strength of their tradition of steady, rising value, became an obvious target for speculators. For a few years, polished diamond prices rose to unprecedented levels at an unprecedented pace.

Polished Diamond Prices To Increase Faster In Future?

However, the diamond boom of 1976-1979 was followed by a massive collapse in 1980. Luckily, in those days, USA and Japan made up the greater market for polished diamonds. Diamond demand had not become globally diversified...like it is today.

According to calculations by Equity Communications, 609 million carats of polished diamonds were produced from 1997 to 2013.

This is what they measured confidently. Of these 609 million carats, it is not known the volume of polished diamonds stored in the diamond pipeline and the volume of polished diamonds bought by consumers.

However, what we know is this:

If polished diamond prices were to fluctuate wildly for any reason, traders and consumers would immediately have a strong financial incentive to liquidate this large stock of polished diamonds. Moreover, diamonds would no longer be symbols of love; they would quickly become just another avenue for speculators to make money, to the eventual ruin of the whole diamond industry.

Thankfully, consumers normally do not have a strong financial incentive for the liquidation of diamond jewellery nor do retailers have a strong business incentive to buy back diamond jewellery sold to customers.

Prices of polished diamonds rise only gradually therefore retailers are in a position to maintain stable sticker prices for diamond jewellery pieces over many months. In retail markets, unless they wait at least ten years, it is very rare for someone to sell a diamond at higher price than they initially bought it.

Furthermore, fast rising prices of polished diamonds would introduce new complicated problems for retailers. Mostly, the business economics of the diamond business are such that retailers require large margins to compensate for the fact that diamond inventory is costly while consumers buy diamonds infrequently. The diamond retailing business is not sustainable in the absence of large margins.

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Polished Diamond Prices To Increase Faster In Future?

If you want confirmation, consumption patterns for gold in both India and China clearly show that high margins for precious jewellery are not defendable once consumers treat it as an investment.

The subject of consumer demand for diamonds is discussed extensively in Equity Communication's Global Diamond Business report so I will not say a lot about it here.

Instead, I am going to bring colour to certain assumptions that have ultimately been bad for the diamond industry. **Industry stakeholders have become rather casual about the need for greater promotion of the diamond dream because of this "supply will outpace demand" story.**

Experts have said that billion people markets of China and India are going to carry the industry forward for many years to come, fuelled by economic growth and wealth creation in these countries.

It is all true. However, it is the intensity of future growth that is not all straight-forward.

For starters, economic growth does not automatically lead to growth in diamond consumption. If that were the case, Europe would be the world's largest diamond region by virtue of it having the largest population of people who potentially afford diamonds.

Anyway, let me show you something from De Beers' Insight Report that should force you to maintain cautious optimism on emerging markets growth prospects.

Please continue to next page...

DIAMOND JEWELLERY RECYCLING

Trading of previously owned diamonds (sellback, trade-up) is a normal part of the lifecycle of jewellery and forms a growing segment of the diamond jewellery industry. However, this activity has attracted greater attention in the diamond industry in recent years, as its scale was boosted not only by the global economic downturn but also by the accompanying appreciation of gold prices during that period. In many cases, consumers wanted to sell back their gold jewellery, and diamonds were simply a by-product; on other occasions, the diamond was the main item being sold back.

Due to the lack of a reliable buy-back offer from traditional retailers, US consumers have increasingly turned to pawnbrokers and to high-visibility, non-specialised new entrants to sell back their diamond jewellery. **Consumers who have sold diamond jewellery through these channels have often left dissatisfied, especially due to a perceived lack of transparency and objectivity in the pricing of their jewellery. Consumers who trade up their diamond jewellery through specialised channels are generally less dissatisfied with their experience.**

The recycling trend could undermine trust in the diamond industry and consumers' belief in the diamond dream. The industry will need to continue to work towards offering consumers expert advice and clear choices when it comes to recycling of diamond jewellery.

Comment

This is just in America.

Now, if there is one crucial thing you should know about the consumption of precious jewellery in both India and China it is this: consumers buy jewellery to accessorize and for investment purposes.

Furthermore, consumers in India and China have no problem trading in jewellery when it rises in value or when they feel like getting a new design. This applies to diamond jewellery as well.

Polished Diamond Prices To Increase Faster In Future?

Overall, precious jewellery is commoditized in Adornment+Investment markets since consumers make purchases for both adornment and investment purposes. Consumers typically monitor carefully movements in the price of precious metals in financial markets when making purchases. For this reason, jewellery manufacturers and retailers have limited leeway (margin freedom) in the pricing of jewellery pieces.

Exhibit 33

Source: Global Diamond Business 2014 report – Equity Communications, August 2014

The market for diamond jewellery in adornment+investment markets would instantly become enormous were diamonds actually a good fungible investment.

Sadly, diamonds are actually not a great financial investment for most people - bought at retail prices and traded-in at wholesale prices - hence the strong emotional association with love needed to drive sales.

For this reason, diamond sales can naturally stall in adornment+investment markets because material considerations are actually the basis of most unions in such societies - for instance, weight of gold at wedding events is of prestigious importance.

Ultimately, the much more limited number of rich people will afford diamond jewellery as status symbols and ancillary jewellery in markets like China. Conversely, as we move further away from the large tier 1 and tier 2 cities, the greater mass market increasingly requires much stronger incentives to buy diamond jewellery since diamonds do not have long-standing cultural utility.

In India's case, you can change your views on the potential pace of growth if you paid closer attention to actions of policymakers in the country. The Indian government recently introduced policies designed to suppress imports of gold for domestic consumption.

Correspondingly, it is highly probable that the government would do the same for diamonds if domestic consumption outpaced diamond exports. Moreover, prohibitive duties are already in place to discourage imports of polished diamonds into India.

In the final analysis, consumption of diamond jewellery in most markets has to fit into local preferences and perceptions about jewellery.

Frankly speaking, I could go on and on this topic but I believe it is adequately covered in the Retail section of the Global Diamond Business report. I just wanted to point out other important factors that are often overlooked in the assessment of emerging consumer markets for diamonds.

The Point of View letter is for clients of Equity Communications. Subscription to the Point of View letter is automatic and free to clients who obtain a copy of the Global Diamond Business 2014 report - Equity Communications' comprehensive report on the Global Diamond Industry.

Mr Tinashe Takafuma writes the Point of View letter in his capacity as Head of Diamond Industry Research at Equity Communications. He is also lead writer of the Global Diamond Business 2014 report.

His views are based on his reading of the diamond industry and precious jewelry markets at time of publication of each issue. Therefore, his opinions may diverge from those reflected in the Global Diamond Business 2014 and other research publications by the Diamond Industry Research Team at Equity Communications. Such reports are based on a longer time horizon and reflect the full input of the Diamond industry Research Team.

The Point of View series provides more color to themes and insights from the Global Diamond Business 2014 report. Furthermore, Mr Takafuma offers helpful advice plus his point of view on topical subjects as they happen in the global diamond industry and precious jewelry markets.

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