

## Objective Capital's Precious Metals Investment Summit:

### The Gemstone Industry 2010 and Beyond

The great thing about gemstones is that they are totally useless and valueless. Except in the eye of the beholder. Nothing demonstrated this more than the economic crash of late 2008-2009. Whilst the market in industrial commodities took a major hit, the diamond market disappeared. Nothing can give you a stronger message about your product than demand drying up completely.

Yet here we are, but a year into recovery, with prices strengthening daily and talk of longterm shortages in stones. Are these variables around which you can build a business? Apparently yes.

The world trade in rough diamonds is around \$12 billion and has a prognosis of \$17 billion by 2019. There is a 50% uplift in price with polished goods, thus \$18 billion. It does not compare with the major industrial minerals, but once polished and made into jewellery, it has a saleable value of \$76 billion. For comparison, refined gold, at \$1100 an ounce, is worth \$88 billion and aluminium only \$52 billion. Diamonds represent c. 90% of the gemstone mix. They support upwards of 70 public companies.

Only a handful of non-diamond gemstones miners are quoted on stock exchanges. They include:

- Gemfields (Emeralds, Zambia, AIM:GEM)
- Tanzanite One (Tanzanite, Tanzania, AIM:TNZ)
- True North Gems (Rubies, Greenland, TSX:TGX)

### Changes in the Past Two Years:

The past two years have seen possibly the greatest turmoil ever in the gemstones trade. Highlights – and lowlights – have included:

**Demand:** A seemingly unstoppable rise up to late 2008 followed by an even more marked collapse into late 2009. Then came a recovery which has brought us back to perhaps 80% of peak.

**Marketing:** De Beers share of the rough diamond market shrank from c. 80% 15 years ago to c. 35% now. With their fall went the control of price and supply affected by the De Beers stockpiles, its sightholder system and the Central Selling Organisation or CSO. Alongside has come the open auction tender system.

**The Kimberley Process:** This export certification scheme applies only to rough diamonds. It is intended primarily to stop the flow of stones which have been produced using unfair labour practices or to fund terrorism. Whilst still imperfect it has had a measurable effect on trade. In particular it has disrupted the flow of disputed goods from the Marengue field in Zimbabwe.

**Polished Diamonds Certification:** There is as yet no unified system for this but it is being actively developed.

**Polished Coloured Stones Certification:** In some respects, coloured stones have come further than diamonds in terms of ethical provenance of the finished goods. The mined origin of a coloured stone can often be more easily determined by its physical appearance and impurities. Thus a Ceylon blue sapphire, a Burmese ruby. A system being aggressively pursued is the "mine-to-market" principle. As the name implies it tracks a stone from the mine through each stage until it hits the retail store. A leading proponent is Columbia Gem House of the USA. CGH verifies mined sources before cutting, polishing and grading, using all in-house facilities. This technique is increasingly attracting the attention of major outlets, including Tiffany. CGH also manufactures a range of its own jewellery which flags ethical – or otherwise – sources of precious metals. This particular process has far to go, but is being worked on. Our family-run business, Fair Trade Gemstones, is the UK and European distributor for CGH.

**Nationalism:** Some countries are highly dependent upon their revenues from diamond mining. They include Botswana, Lesotho and Namibia. Ironically they collectively offer good

codes of practice and workable taxation systems. Others, such as Angola and the DRC do not.

**Local Beneficiation:** India cuts and polishes about 75% of all the world's gemstones, particularly its smalls. Thus "Indian goods". There is a strong movement amongst major mine producers to encourage cutting at source. This is a reasonable progression in terms of added value but its implications include training and labour costs. India hits positive in both, as does China. Canada now has a cutting facility in Sudbury, Ontario but not at its mines in the climatically hostile north. Botswana has made the greatest progress, aided and abetted by De Beers. It now has grading and cutting facilities and holds regular tender auctions. This is entirely feasible given the country's output (almost 20% of world mined diamonds and accessibility.) South Africa has used a carrot and stick approach; lower export royalties on polished goods. In parallel with establishing cutting and polishing centres it also holds regular auction tenders. Others, such as Angola, DRC, Sierra Leone should think carefully about their housekeeping before attempting to follow suit. A primary consideration in the economics of cutting diamonds and indeed all precious gems, is size. India and increasingly China, predominate in stones below a quarter carat. At the upper end, say above 2 carats, high skills are necessary because of the sales value of larger stones. So the fledgling centres are, for some time, probably stuck with +0.25 – 1.5 carat stones.

### ***2010 – 2011 and Beyond***

Will the economic recovery last? If so for how long? What will it mean for gemstones? Those who buy into the belief that it was all Lehman Brothers' fault, think we are over the crash, have learnt our lessons and are full steam ahead for growth. We may be, but it has bred caution. Money is not flooding into explorers, despite worrying of longterm shortages of diamonds. Simply, the lead times from exploration to production are too long for the average investor. Established pipe and fissure mines are getting older, deeper, and more expensive. New ones are not on the horizon. So tailings retreatment and alluvials are the nearby focus. This does not feature Australia, Canada or Russia for climatic reasons. It focuses South Africa, so long as it corrects its recent political-economic wobble. For the most part it highlights West Africa: Angola, DRC, Sierra Leone, and Guinea, whose recent histories leave much to be desired and little to the imagination. All information about the Merange, Zimbabwe diamond field must be treated with caution. Its potential, for the most part low grade, is potentially huge.

The relationship between production and consumption will always be the defining feature of the industry. The consumer can turn off the tap with a flick of the wrist. The producer is committed to the death. In this last cycle, more than a few have fallen. Others will.

There will be a continuation of M&A and even a few more hopefuls, joining the race.

A note on which to end is the rumour floated that De Beers will return to a stock exchange quotation. Well it might. Its 45% shareholder Anglo American would probably heave a sigh of relief. Anglo is surely growing weary of pulling out its wallet to support a company which is treading water. Who might subscribe to a floatation? Don't miss next year's exciting episode....

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