

Objective Capital: Global Mining Investment Conference London  
Keynote Diamond Presentation  
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In the peacetime history of global, organised commodity trading only a few events have proved to be of long-term significance as opposed to bubbles. Most took place in the 1970's and were war-related:

- The OPEC initiative took oil from \$1.50 to \$10 per barrel in short order, in 1972.
- The freeing up of the gold price, to allow the USA to pay for the Vietnam War, lifted the bar from a fixed \$35 per ounce to \$100 and more, in 1973.
- Cobalt, the minor metal indispensable in jet engines, ran from \$3.5 per pound to \$42 in a few weeks as a result of a skirmish in Zaire, in 1981.

Ultimately, all wars end in a sort-of peace and life becomes normal again. But what of the collapse in the diamond market in 2008-2009? Whilst it is too early to tell whether it was a bubble or definitive shift, it was certainly dramatic.

***As the diamond market seeks its return to normality, what, we ask, is normality?***

Less than 10 years ago, the diamond market was a cosy place to be. De Beers effectively controlled the world's trade in rough by its own production, its sales link with Russia's Alrosa and the overwhelming power of its Diamond Trading Company's sight-holder system. De Beers also had a major influence on the South African Stock Exchange, the comfort of the great mining house Anglo American as a major shareholder and was responsible for the wellbeing of whole countries such as Botswana and Namibia. Its powerhouse remained South Africa but the times were a-changing. Diamonds were being found in Canada, the post Apartheid RSA government was eyeing De Beers as a primary target in the house of correction and the Kimberley mines were becoming old and tired.

***Time for a change.*** In just a few years, from 2001, De Beers privatised itself, moved its headquarters back to London and sat back in the relative comfort of its fellow shareholders. Anglo American held on to 45%, Botswana (by then the world's largest producer by volume and value) 10% via its government and the capital expenditure began to flow into the new production province of Canada. The market monopoly was eroded, the giant DTC stockpile dissipated and a new game was on. The entry of fresh-faced new junior companies became a stampede on the AIM, ASX and JSE exchanges. Two notable mining conglomerates, Rio Tinto and BHPB, consolidated their positions too.

All this coincided with a period of world economic prosperity. The demand for luxury goods rose and with it the price of and demand for, diamonds. There appeared to be room for all, yet the industry stratified. The European Union insisted that De Beers break its marketing agreement with Russia's Alrosa on anti-competition grounds. Well backed larger companies such as Gem Diamonds and Petra were formed and the world became a monopoly board. The whole of sub-Saharan Africa, Canada, Australia, Brazil, northern Europe, Zimbabwe even. But the end of a monopoly means the start of a free market. Here is how it has unfolded.

***Two years ago, a presentation at a meeting like this would have reminded you of these facts:***

- The world output of rough diamonds at c. 160,000 carats was growing at about 10% per year, but many big, old mines were facing exhaustion.
- Demand was maybe growing by 15% annually with the Chinese and Indians catching-on. New sources were needed and quickly. So even the DRC and Angola were becoming more popular, despite incipient corruption and a lack of infrastructure.
- The bulk of rough stones weighed in at less than half a carat each and the going rate on the increasingly important auction tender system had advanced from \$30 to \$50 per carat.

Self congratulation was the order of the day. A leader of industry was recorded as saying: "If you must be in commodities, diamond is the place to be".

It got better. By early 2008, run-of-the-mill smalls were pushing \$80 and larger stones were breaking records.

### ***Then came the crunch.***

Some blame the international economic failure of July-September 2008 entirely on the collapse of Lehman Brothers. Not true. The system was over geared on competitive credit and a major correction was due. No sector and no commodity was hit harder than diamonds. Market prices for smalls fell in a straight line to \$30 by November, at which point nobody was turning up at the tenders. Few companies can survive some months without cashflow or in operating at a loss. Responses to the crash were mixed. Some miners continued operating but stockpiled rather than selling in the bargain basement. Some went on care and maintenance. Others went metaphorically to jail; directly to jail. They did not pass GO and they certainly did not collect two hundred. It was rolling the dice time.

De Beers was forced to lean on its fellow shareholders for interest free loans to keep the banks at bay. Only Rio Tinto and BHPB were to an extent spared because diamonds are a relatively small (10% - 15%) contributor to overall earnings.

### ***Now the better news.***

Whilst the jury is still out on the strength and longevity of economic recovery, we are having one and with it, a resurgence in diamond prices and demand. The market smalls are now \$40 - \$45 and the Christmas season looms. It looks better than we could have dreamed six months ago. But this cycle has brought about some probably permanent changes in the gemstone market.

### ***What changes?***

- Buying and selling. The development and expansion of the auction-tender house system arose from De Beers' effective abandonment of its monopoly on rough sales. As a result a wholesaler or even retailer can bid at auction, find a friendly cutter polisher, designer and cut out a lot of middle people. In addition the auction system is cash on delivery.
- Exploration. Perhaps one in one hundred kimberlite diamond pipes proves payable. Alluvials are fast track. It all depends on the patience of your investors, and the deposit you choose.
- Location. Politicians are not noted for being at the forefront of economic realism. We are still seeing mining laws and terms of engagement being hardened from Angola to Zimbabwe, via Brazil and stations east. Surely the market has had a timely reminder that the diamond industry is not a one way ticket to heaven. It remains what it always was, a tough industry.

In the coming months we shall record stories of success, survival and failure. The only constant will be change.

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