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# QUARTERLY COMMODITY INSIGHTS BULLETIN



cutting through complexity

Q4 – 2012



## Diamond

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### Another tough year in 2013?

The global diamond market continues to face uncertainty in the months ahead, which may result in 2013 showing little improvement over what was a fairly depressing 2012. While there may not be an actual fiscal cliff for the world to fall off, the reality is that the disagreements between the Democrats and Republicans in Washington have made consumers nervous about spending. As a result, one of the first casualties is demand for polished diamonds. This, combined with lower growth rates in two of the world's key diamond markets (India and China), has resulted in pressure on the prices of polished diamond. On the other hand, hurdles in the supply of rough diamonds (some planned, others not — such as flooding in both Jwaneng in Botswana and Venetia in South Africa) is likely to result in an increase in rough prices in the near term — thus putting additional pressure on the polishing industry margins if they are unable to transfer the cost increases on to the retailers.

The light at the end of the tunnel for all players in the industry is the hope that the demand–supply gap will widen in the medium to longer term (demand and supply are expected to increase by approximately 6 percent and 3 percent per annum, respectively) between now and 2020. However, the curtailing of exploration activities since the 2008 financial crash have resulted in very few new mining sources expected to add to the supply in the next 5 to 10 years. In addition, a number of the world's largest mines will need to go the more-expensive underground route. These factors should see a steady increase in the price of polished diamonds over the period, which should filter through to the rest of the industry.

### Commodity outlook

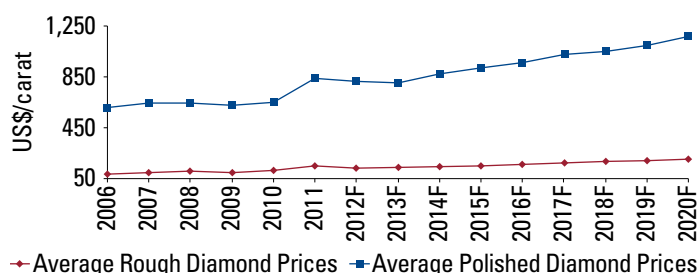
The diamond industry witnessed a bumpy run in 2012. The year began with the Israeli police making arrests on the Israeli diamond exchange in relation to money laundering, illegal foreign exchange and unlawful loans. Subsequently, hundreds of synthetic CVD diamonds were sold without being recognized as fakes, thus creating panic in the global diamond mining industry. It was a reminder that CVD diamonds cannot be identified without special equipment, even by seasoned diamond traders.

Significant shifts were seen in the dynamics of ownership changes in the global diamond industry. This included the largest deal of 2012 — the US\$5.1 billion sale of the Oppenheimier stake in De Beers — marking the family's exit from a business with which its name had been associated for almost 85 years. The second-largest deal of 2012 was the sale of Rio Tinto's Ekati mine to Harry Winston for US\$500 million.

The global diamond industry demand witnessed weakness and caution in 2012, leading to lower inventories and consumers shirking away from diamond purchases. India, which is the third-largest diamond-consuming industry, witnessed weak demand through the year. The decision by the Indian government to impose a 2 percent duty on polished diamonds and the country's weak rupee further pulled down domestic demand as it presented challenges to those within the trade. In addition to the Indian market, the Chinese diamond market experienced weakened demand driven by uncertain economic conditions. However, things are expected to look up in 2013, with growth in demand from the middle class in India and China. Nevertheless, while there is an expected optimism about 2013, the year has started with many similar characteristics of 2012, including weak market demand and significant caution among industry players and consumers.

The global rough diamond prices are expected to have dropped 16 percent in 2012 — an event witnessed for the first time in four years. The RapNet Diamond Index showed that the 1-carat diamond prices are expected to fall over 12.5 percent, 3-carat diamonds more than 11 percent, 0.5-carat diamonds 11.1 percent and 0.3-carat diamonds expected to fall 7.4 percent in 2012. With the expected widening in the demand–supply gap in the medium- to longer-term, prices are expected to stabilize. As per a report from BMO capital markets, rough diamond prices are expected to show an overall growth of 3 percent in 2013, though most of the price appreciation is expected in the later part of the year. From 2014, rough diamond prices are expected to grow 5–7 percent per annum till 2020, as growing demand from emerging markets is expected to outstrip the supply.

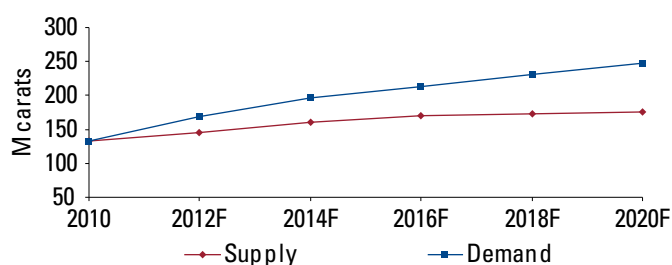
**Figure 1: Average diamond prices (2006–20F)**



Source: ScotiaBank; BMO capital markets

## Supply and demand

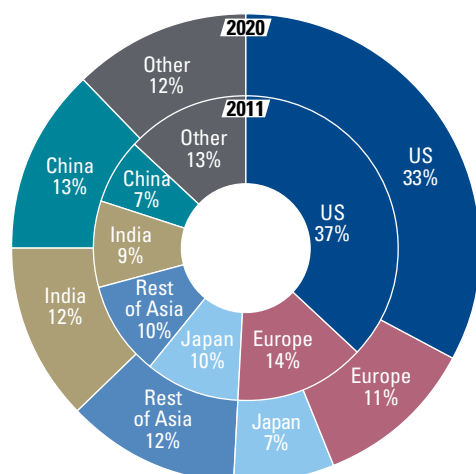
Figure 2: Supply and demand of rough diamonds (2010–20F)



Source: Bain & Company

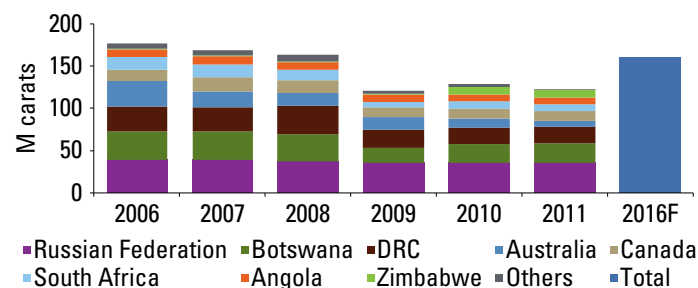
- The US was the world's largest diamond market in 2012, with revenues of more than US\$27 billion, slightly recovering from the 2008–09 financial crisis, which had led to a y-o-y fall of 18 percent in diamond jewelry sales in the country. Though the market rebounded somewhat in 2012, revenues recorded are only slightly above those of 2000.
- China has grown rapidly to become the world's second-largest market for diamonds, with annual sales of almost US\$9 billion in 2012, driven by increasing individual wealth and the fast-expanding Chinese middle class, which grew at a CAGR of about 10 percent last year. Previously, the Chinese demand for diamonds grew at a CAGR of 32 percent between 2005 and 2011. The coming years also look good for diamond demand in China. There is a large growth opportunity for the Chinese diamond retailers in the form of low market penetration among the lower-income Chinese who make up half the country's 1.34 billion population.
- India is expected to have been the third-largest diamond market in 2012 with annual revenues nearing US\$8.5 billion. Diamonds are the country's second-fastest-growing discretionary purchased items, next only to mobile phones. The country's diamond demand grew at a CAGR of about 10 percent in 2012, and at 22 percent between 2005 and 2011.
- With an increase in the rough diamond consumption by the growing middle class in China and India, the global consumption is expected to be valued at about US\$26.1 billion in 2020 up from its 2011 level of US\$15.6 billion, implying a CAGR of about 6 percent.

Figure 3: Comparison of diamond demand in 2011 vs 2020



Source: Bain & Company

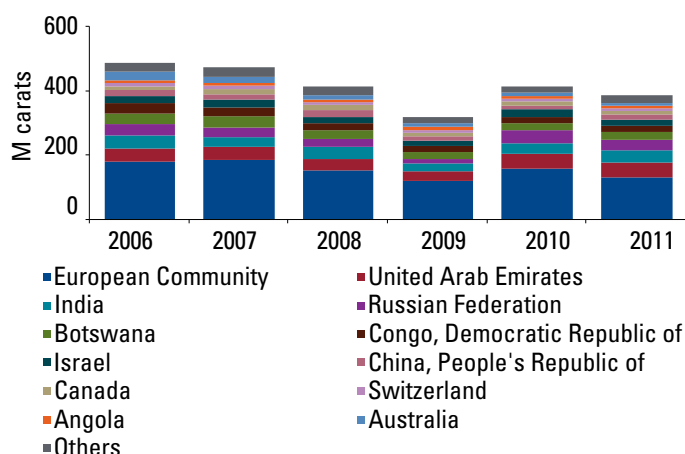
Figure 4: Global rough diamond production (2006–16F)



Source: Kimberly process certification scheme, BMO, KPMG analysis

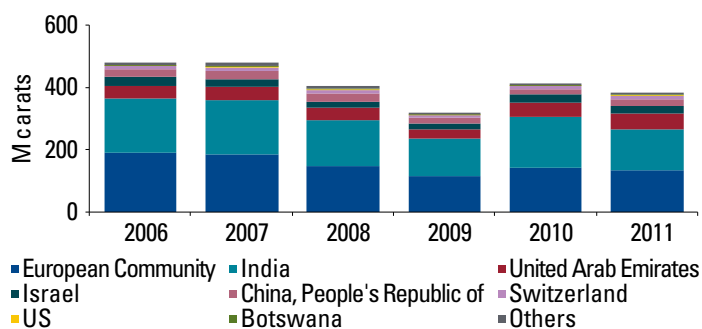
- In H1 2012, the value of Russian diamond exports stood at US\$1.8 billion, exhibiting a y-o-y increase of 7.5 percent over H1 2011. However, the export of diamonds, by volume, decreased 15 percent from 18.1 million carats in H1 2011 to 15.4 million carats in H1 2012.
- Botswana saw lower-than-expected diamond mining output due to subdued demand from key consuming markets such as China. In addition, the reduced output from the mining sector, due to the global economic slowdown, is expected to drag the country's economic growth rate to 3.5 percent from the previous estimates of 4.4 percent drawn in the annual budget in February 2012.
- South Africa's diamond sector is expected to continue its slow recovery following the global recession, with companies gradually ramping up production to pre-crisis levels. The country reported diamond production of about 11.1 million carats in 2011, which formed approximately 10 percent of the global output. The South African diamond output is expected to reach 12.5 million carats per annum in 2017.
- Zimbabwe has the potential to become one of the world's largest diamond-producing nations following its Kimberly Process certification to export diamonds. In 2012, Zimbabwe, through its mining firm Zimbabwe Mining Development Corporation (ZMDC), produced 8 million carats of diamonds. As per ZMDC projections, the country's overall production is expected to reach 16.9 million carats in 2013.
- The De Beers group estimated that its production fell by 11 percent y-o-y to 27.9 million carats in 2012 due to the company's increased focus on waste stripping, maintenance and also due to experienced operational difficulties during the year.

Figure 5: Global rough diamond exports (2006–11)



Source: Kimberly process certification scheme, KPMG analysis

**Figure 6: Global rough diamond imports (2006–11)**



Source: Kimberly process certification scheme, KPMG analysis

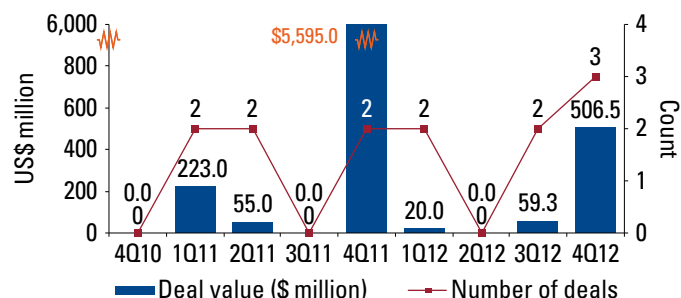
## Key developments

### Ownership changes

In 4Q12, the total value of major deals announced in the diamond industry was US\$506.5 million, up from

US\$59.33 million in 3Q12, representing an eight-times q-o-q deal value increase. The number of deals announced during 4Q12 increased to three, against the two announced in 3Q12. Out of the three, one was successfully closed.

**Figure 7: Value of major deals announced in the diamond industry during 4Q12**



Source: Mergermarket Factiva, KPMG analysis

**Table 1: Top diamond deals announced during 4Q12**

Quarter	Date announced	Target (Nation)	Acquirer (Nation)	Status	Value of transaction (US\$ million)	Stake (%)
4Q12	5-Dec-12	IGE Resources AB (Sweden)	Amarant Mining Ltd. (Dubai)	Completed	NA	29.71
4Q12	3-Dec-12	Gem Diamonds Australia Holdings Pty Limited (Australia)	Goodrich Resources Ltd. (Australia)	Announced	14.3	100
4Q12	13-Nov-12	BHP Billiton's diamond assets (Canada)	Harry Winston Diamond Corporation (Canada)	Announced	500	100

Source: Mergermarket, Factiva

### Regulatory updates

The regulations introduced during 4Q12 were intended to increase the state revenue from diamond mining by implementing taxes on larger mining projects.

**Table 2: List of recent regulations in diamond industry**

Country/ Region	Regulation/topic	Description
Uruguay	Progressive tax at State Level	<ul style="list-style-type: none"> <li>The country plans to implement a progressive tax on larger mining projects above 40 ha, and those having a minimum investment and annual sales revenues of 830 million standard units.</li> <li>A tax of between 0.25 percent and 90 percent will be charged over the difference between the company's operational profit and its input costs.</li> </ul>

## Projects

**Table 3: Major project updates in diamond mining industry**

Project	Company	Location	Potential start up	Potential output (mctpa)	Potential life of mine (in years)
Finsch	Petra Diamonds Limited (74%); Senakha Diamonds Investments (Pty) Ltd (21%); Petra Diamonds Employee Share Trust (5%)	South Africa	2017	Expected to increase from 1.4 to nearly 2 mctpa	18
Kimberley underground	Petra Diamonds (74%); Sedibeng Mining (Pty) Ltd (26%)	South Africa	2016	Expected to increase from 0.068 to 0.135 mctpa	10
Voorspoed	De Beers (74%); Ponahalo holdings limited (26%)	South Africa	2014	Expected to increase from 0.7 to 0.8 mctpa	NA
Williamson	Petra Diamonds (75%); Government of the United Republic of Tanzania (25%)	Tanzania	2016	Expected to increase to 3.6 mctpa	18
Argyle underground development	Rio Tinto (100%)	Australia	2013	NA	NA
BK11	Firestone Diamonds (90%); Botswana Nationals (10%)	Botswana	2011	The mine was put under temporary care and maintenance in February 2012. Operations have yet not been restarted.	
Liqhobong mai treatment plant	Firestone Diamonds (75%); Government of Lesotho (25%)	Lesotho	2015	1.0	NA
Grib	LUKoil (100%)	Russia, Arkhangelsk	2013	NA	NA
Kao	Namakwa (62.5%); Kimberlite Investments (12.5%); Government of Lesotho (25%)	Lesotho	2012	0.1	21
Lace mine	Diamond corp. (74%); Sphere Holdings (Proprietary) Limited (13%); Shanduka Group (Proprietary) Limited (13%)	South Africa	2015	0.5	25
Gahcho Kue	De Beers (51%); Mountain Province Diamonds (49%)	Canada	NA	4.5	11
Renard	Stornoway (100%)	Canada	NA	1.6	11
Bunder	Rio Tinto (100%)	India	2016	NA	25

Note: Project names are hyperlinked to source links.

Source: Business Monitor International; Deutsche Bank; BREE; Intierra; Company Reports