

COMMODITY INSIGHTS BULLETIN

Diamond (2Q, 2013 and 3Q, 2013)

Introduction

The international diamond sector witnessed the successful conclusion to the migration of the De Beers aggregation and sales activities from London to Gaborone with the first sight held for sightholders of De Beers Global Sightholder Sales (DBGSS) on 11-14 November 2013 in Gaborone. By all accounts, the migration has been very successful with many Sightholders expressing their satisfaction with the facilities and organization. Despite this highlight of the year, a

number of challenges will continue to affect the industry going forward. These include complaints of tight margins by the polishers and retailers, the spectre of synthetic diamonds coupled with the declining spend by the industry on marketing, branding and advertising, and the more conservative approach adopted by the financial institutions. These issues will need to be addressed and resolved sooner rather than later.

Commodity outlook

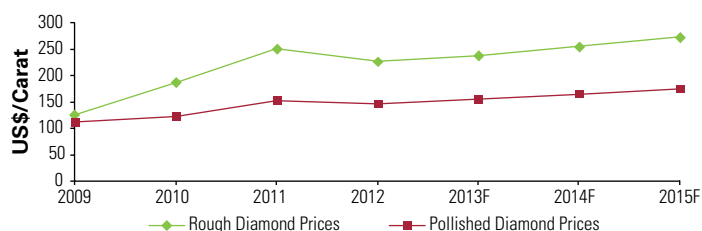
Rough diamond prices for the first half of 2013 held steady, further eroding diamond cutters' margins and carrying over the momentum built toward the end of 2012.¹ Meanwhile, polished diamond prices improved only marginally YTD.² The market showed signs of improvement with encouraging trends observed in the demand from the US, Japan, China and India.³

The diamond market in the key developing markets of China and India witnessed a moderated YTD growth in 2013, primarily due to a general wider economic slowdown. Europe also witnessed lower sales for the same reason. However, diamond sales in the US and Japan, the largest and third-largest diamond markets in the world, respectively, increased due to an increasing GDP growth.³

In addition to the demand recovery in the US and Japan, India and China are expected to continue as key growth markets globally, driven by their changing demographics and consumer buying behavior. Diamonds are also expected to remain a strong case for investment with the return in demand from the US.¹ Going forward, the prices of rough diamond are expected to increase by five percent in 2013 and 7 percent per annum in 2014 and 2015. The prices for polished diamonds are expected to increase at a CAGR of 6 percent through 2015.⁴

As per the Global Diamond Report 2013, during the previous few years, the demand-supply for diamond has reached a state of rough balance, which is expected to continue through 2017. However, during 2018–23, the diamond industry is likely to witness a shortfall as the supply is expected to decline at a CAGR of 1.9 percent. The main cause for this long-term decline in supply is the depletion of existing mines and a dearth of significant new discoveries. Also, new projects that are expected to come online will not be large enough to generate significant demand growth during this period.³

Figure 1: Diamond price trends (2009 – 15F)



Source: VTB Capital – VTB Capital: Base And Precious Metals Watch – September 2013; Growth Patterns Remains Volatile, October 15, 2013; Pamure Gordon & Company – A Diamond is Forever, but Especially for this Christmas, June 10, 2013, via Thomson research/Investext, accessed November 2013

¹ Charles Stanley Securities – The Quarterly Carat Issue VII, July 22, 2013, via Thomson Research/Investext, accessed November 2013

² VTB Capital – VTB Capital: Base And Precious Metals Watch – September 2013; Growth Patterns Remains Volatile, October 15, 2013, via Thomson research/Investext, accessed November 2013

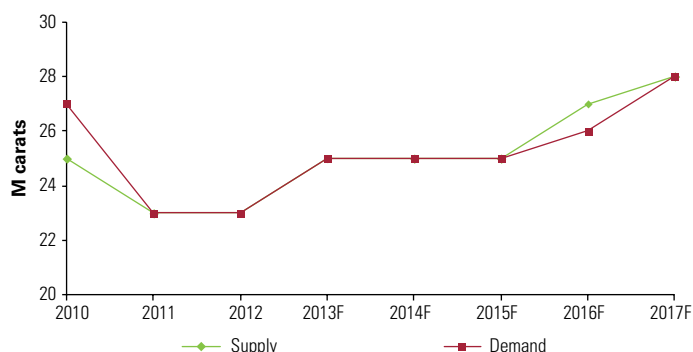
³ “The Global Diamond Report 2013, Journey through the Value Chain,” Bain and Company, August 2013

⁴ Pamure Gordon & Company – A Diamond is Forever, but Especially for this Christmas, June 10, 2013, via Thomson research/Investext, accessed November 2013

Supply and demand⁵

Demand

Figure 2: Supply and demand of polished diamonds (2010 – 17F)



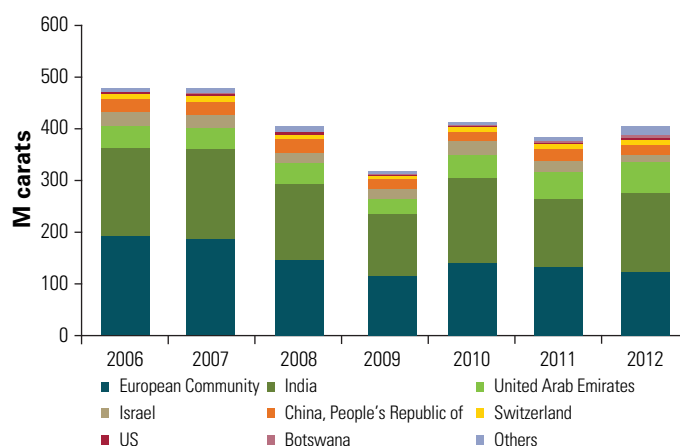
Source: BMO Capital Markets – Global Commodities Research – Commodity Canvas – Q4/13: Home On A Range, October 17, 2013, via Thomson Research/Investext accessed November 2013

- The US remained the largest diamond consumer with 37 percent of the global demand in 2012. Its demand for diamond jewelry is expected to recover strongly returning to its 2007 level by 2015 as the country continues along its current recovery path. Thanksgiving to Christmas is the main diamond-buying period in the country. The wholesale demand for diamond could pick up before the period with retailers building inventories. If the pattern of the past 20 years continues, about 80 percent of all engaged couples will buy a diamond engagement ring this season, boosting the demand for diamond jewelry. Going forward, demand for rough diamonds is expected to increase at a CAGR of 2.4 percent to about US\$8 billion by 2023. Further, if the demand for rough diamonds was to reclaim its historical norm of 67 percent of the overall jewelry market, up from the current value of 49 percent, the demand could grow further.⁶
- Chinese diamond demand is expected to grow to 29 percent of the global rough diamond demand in 2023, as the country's middle class expands and the rural population moves into cities. Middle-class households currently make about 19 percent of China's population, but are expected to grow to up to 44 percent by 2023. The outlook for the diamond jewelry market is also positive. This is driven by factors such as a growing culture of buying diamonds even among the lower income groups, a rebalancing of the economy away from investment toward consumption, positive demographic trends, including continued urbanization, and the growth of a wealthy middle class.⁵ Global mining giant, Rio Tinto has launched a marketing initiative to capture this growing interest in the Chinese diamond market. As per them, the fashion diamond jewelry market in the country is expected to reach about US\$6 billion by 2020.⁷
- The demand for rough diamonds from India is expected to increase driven by a growing middle class, which

is expected to increase from current 16 percent of country's population to 46 percent by 2023. The demand for diamond jewelry has been significantly growing and Indian consumers continue to favor it. The demand for diamond jewelry is expected to grow at 15 percent per annum for the next three years taking the Indian demand to 15 percent of the global demand by 2015.⁵

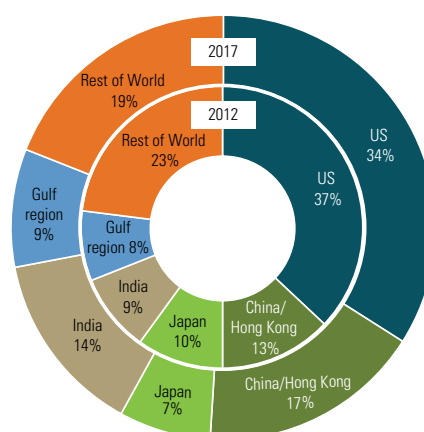
- Japanese demand for diamond remains strong and is expected to recover aided by the impact of fiscal stimulus on economic growth⁸ and consumer behavior. The near-term European demand outlook for diamond remains challenging. However, the demand is expected to recover starting 2014, driven by a gradually improving economic outlook.⁵

Figure 3: Global rough diamond imports (2006 – 12)



Source: Annual Global Summary: 2012 Production, Imports, Exports and KPC Counts, Kimberley Process Rough Diamond Statistics, https://kimberleyprocessstatistics.org/static/pdfs/public_statistics/2012/2012GlobalSummary.pdf, accessed 19 November 2013; Public Statistics Area, Kimberley Process Rough Diamond Statistics, https://kimberleyprocessstatistics.org/public_statistics, accessed 19 November 2013

Figure 4: Comparison of diamond demand in 2012 vs. 2017F



Source: Numis Securities, Metals & Mining Sector update, July 10, 2013, via Thomson research/Investext, accessed November 2013

⁵ "The Global Diamond Report 2013, Journey through the Value Chain", Bain and Company, August 2013

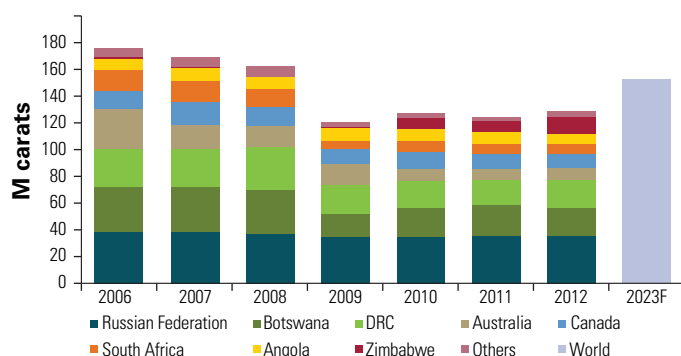
⁶ Pamure Gordon & Company – A Diamond is Forever, but Especially for this Christmas, June 10, 2013, via Thomson research/Investext, accessed November 2013

⁷ Sarah Jane Tasker "Rio Tinto launches marketing initiative to tap into China's love of diamonds," The Australian, 11 November 2013

⁸ Keiko Ujikane & Mayumi Otsuka "Japan's Abe Unveils 10.3 Trillion Yen Fiscal Stimulus: Economy," Bloomberg, 11 January 2013

Supply

Figure 5: Global rough diamond production (2006 – 23F)



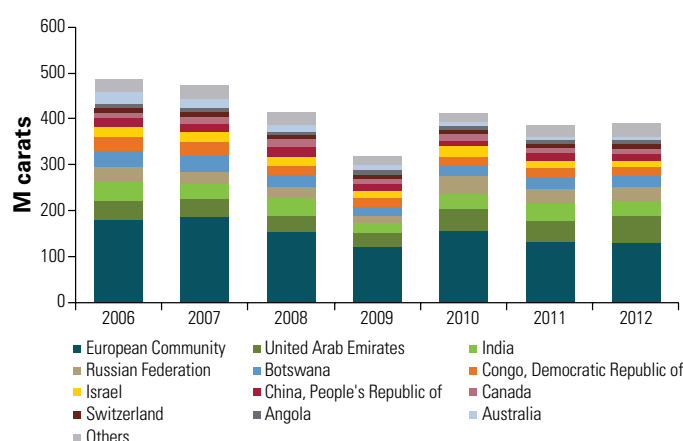
Source: Annual Global Summary: 2012 Production, Imports, Exports and KPC Counts, Kimberley Process Rough Diamond Statistics, https://kimberleyprocessstatistics.org/static/pdfs/public_statistics/2012/2012GlobalSummary.pdf, accessed 19 November 2013; Public Statistics Area, Kimberley Process Rough Diamond Statistics, https://kimberleyprocessstatistics.org/public_statistics, accessed 19 November 2013; "The Global Diamond Report 2013, Journey through the Value Chain", Bain and Company, August 2013

- Global production of rough diamonds increased to about 128 Mcts in 2012.⁹ However, the average price per carat declined by 14 percent to US\$98.81/carats, as production at lower-value regions such as Australia and Zimbabwe increased.¹⁰ During 2012, Alrosa, was the world's largest diamond producer in terms of volume, producing 34.4 Mcts, whereas De Beers was the leader in value terms, with rough diamond sales of US\$5.5 billion.
- The Russian federation, the world's largest diamond-producing region, produced about 35 Mcts of diamond, contributing about 27 percent of the global rough diamond production in 2012, by volume.⁸ Alrosa, produced about 9.6 Mcts and 9.9 Mcts in 2Q13 and 3Q13, respectively. This was attributed to improved operations at its mines in Russia's Far East regions.¹¹ However, the country's federal and regional governments are planning to sell 14 percent of their shares in Alrosa to support the state finances.¹²
- The Democratic Republic of Congo (DRC) was the second-largest diamond producer in the world, by volume, with a production of about 22 Mcts, which is 17 percent of the global production.⁸ Although the DRC is Africa's largest producer of diamond, a major share of this production comes from the informal sector.¹³
- Botswana was the third-largest diamond producer by volume, but the largest diamond producer by value. The country produced about 21 Mcts of diamonds valued at

about US\$2.9 billion. This high revenue can be attributed to the high average price per carat that the country's diamonds realize as compared to those from other significant producers such as Russia and the DRC.¹⁴ One of the country's biggest advantages is that it houses the Jwaneng mine, which is the world's richest diamond mine by value.¹⁵ In addition, De Beers has signed an agreement with the Botswana government to relocate its London-based sales activities to the country by the end of 2013.¹⁶ As a result, the capital city of Gaborone is fast expected to become a hub for the diamond cutting and polishing industry with diamond-related companies setting up factories in the city in anticipation of the De Beers relocation.¹⁷

- Zimbabwe has emerged as the fourth-largest diamond producer by volume, producing about 12 Mcts of rough diamond in 2012.¹² While it has the potential to become one of the world's largest diamond producers, there are significant risks that could hamper this growth. The country faces significant political risks as elections could generate widespread violence and pressure. Also, the government is in the process of implementing a law that requires a majority share in mining companies to be owned by indigenous Zimbabweans. Additionally, there is the risk that countries may boycott Zimbabwean diamonds, as there have been frequent claims of human rights abuse in their diamond fields.¹⁸

Figure 6: Global rough diamond exports (2006 – 12)



Source: Annual Global Summary: 2012 Production, Imports, Exports and KPC Counts, Kimberley Process Rough Diamond Statistics, https://kimberleyprocessstatistics.org/static/pdfs/public_statistics/2012/2012GlobalSummary.pdf, accessed 19 November 2013; Public Statistics Area, Kimberley Process Rough Diamond Statistics, https://kimberleyprocessstatistics.org/public_statistics, accessed 19 November 2013

⁹ Annual Global Summary: 2012 Production, Imports, Exports and KPC Counts, Kimberley Process Rough Diamond Statistics, https://kimberleyprocessstatistics.org/static/pdfs/public_statistics/2012/2012GlobalSummary.pdf, accessed 19 November 2013

¹⁰ Charles Stanley Securities – The Quarterly Carat Issue VII, July 22, 2013, Via Thomson Research/Investext, accessed November 2013

¹¹ "Russian diamond miner Alrosa's Q2 output rises 16%", Mineweb, 7 August 2013; "Russian diamond miner Alrosa's output rises", Business Report, 11 October 2013

¹² "UPDATE 4-Russia to cut stake in diamond miner Alrosa", Reuters, 2 October 2013

¹³ Democratic Republic of Congo, Diamond Empowerment Fund, <http://www.diamondempowerment.org/education-initiatives/diamond-producing-countries/democratic-republic-of-congo/>, accessed 21 November 2013

¹⁴ Annual Global Summary: 2012 Production, Imports, Exports and KPC Counts, Kimberley Process Rough Diamond Statistics, https://kimberleyprocessstatistics.org/static/pdfs/public_statistics/2012/2012GlobalSummary.pdf, accessed 19 November 2013

¹⁵ Jwaneng, De Beers, <http://www.debeersgroup.com/operations/mining/mining-operations/debswana/jwaneng/>, accessed 21 November 2013

¹⁶ Jaco Maritz "How Botswana is positioning itself as a major diamond hub", How we made it in Africa, 7 November 2013

¹⁷ Rob Young "Botswana: From sleepy backwater to global diamond hub", BBC News Business, 20 August 2013

¹⁸ Business Monitor International – Industry Forecast – Diamonds: Sector Faces Uncertain Future, June 26, 2013, via Thomson Research/Investext accessed November 2013

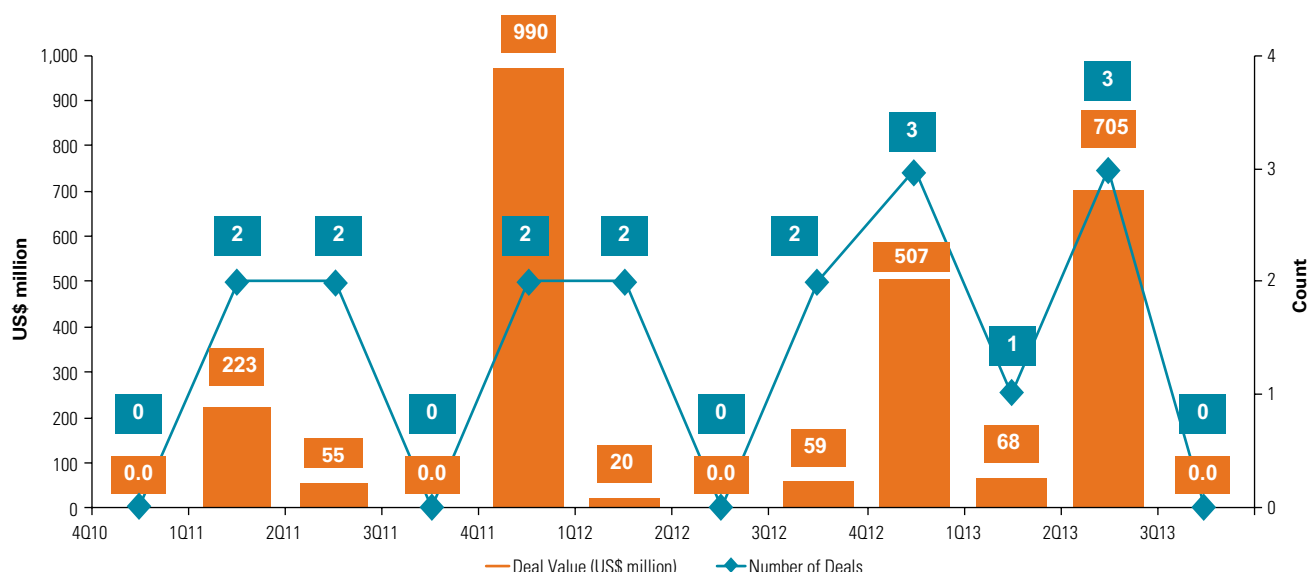
Key developments

Ownership changes¹⁹

In 2Q, 2013, the total value of major deals announced in the diamond industry was US\$705 million, up 937 percent from the US\$68 million in 1Q, 2013. The deal valuation subsequently

declined to nil during 3Q13. The number of deals announced during 2Q, 2013 increased to three, against one announced in 1Q13. Out of the three, one was successfully closed.

Figure 7: Value of major deals announced in 2Q and 3Q13



Source: Deals: Search, Mergermarket; KPMG analysis

Table 1: Top diamond deals announced in 2Q and 3Q13

Quarter	Date announced	Target nation	Acquirer nation	Status	Value of transaction (US\$ million)	Stake (%)
2Q13	26-Jun-13	Black Diamond Holdings LLC (US)	BGS Acquisition Corp. (US)	Lapsed	400	100%
2Q13	24-Jun-13	Afferro Mining Inc. (Canada)	International Mining & Infrastructure Corporation Plc (UK)	Announced	200	100%
2Q13	06-Jun-13	OJSC Nizhne-Lenskoye (Russia)	OAO Almaz Anabara (Russia)	Completed	105	49%

Source: Deals: Search, Mergermarket; KPMG analysis

Regulatory updates

The regulations introduced in 2Q and 3Q, 2013 were intended to streamline the mining industry.

Table 2: List of recent regulations in the diamond industry

Country/Region	Regulation/topic	Description
Liberia	Revamp of diamond mining laws ²⁰	<ul style="list-style-type: none"> Liberia is in talks with parties that have a vested interest in the country's mining sector to alter its laws covering the mining of diamonds and other ores. The new rules will consider the various changes and problems that plague the country's diamond industry.
India	Mining Regulatory Authority ²¹	<ul style="list-style-type: none"> India is planning to set up a National Mining Regulatory Authority as per new mines and mineral development legislation. The authority will have the directive to conduct investigations and prosecute in cases of illegal mining of major minerals.

¹⁹ Mergermarket database, accessed 18 November 2013

²⁰ "Liberia To Revamp Its Diamond Mining Laws," The Israeli Diamond Industry, 23 July 2013

²¹ Ajoy K Das "India to set up mining regulatory authority under new legislation," Mining Weekly.com, 26 April 2013

²² André Janse van Vuuren "South African mining law changes to raise costs," Mineweb, 13 June 2013

Country/ Region	Regulation/topic	Description
South Africa	Changes in mining law ²²	<ul style="list-style-type: none"> • South Africa has amended its mining law. The Mineral and Petroleum Resources Development Amendment Act came into effect on 7 June 2013. • A number of significant amendments to the country's mineral regulatory regime were introduced through this law.

Projects

Table 3: Cross section of global project in diamond mining industry*

Project	Company	Location	Potential start up	Potential output (mctpa)	Potential life of mine (in years)
Finsch	Petra Diamonds	South Africa	2019	Expected increase from 1.4 to nearly 2 mctpa	25
Kimberley underground	Petra Diamonds	South Africa	2016	Expected increase from 0.068 to 0.135 mctpa	12
Voorspoed	De Beers	South Africa	2015	Expected increase from 0.7 to 0.8 mctpa	
Williamson	Petra Diamonds	Tanzania	2017	Expected increase to 5 mctpa	50
Argyle underground development	Rio Tinto	Australia	2013	NA	7 (Until 2020)
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	NA
Grib	LUKoil (100%)	Russia, Arkhangelsk	Dec-13	NA	NA
Kao	Namakwa (62.5%); Kimberlite Investments (12.5%); Government of Lesotho (25%)	Lesotho	H112	0.15	21
Lace mine	Diamond corp. (74%); Sphere Holdings (Proprietary) Limited (13%); Shanduka Group (Proprietary) Limited (13%)	South Africa	H115	0.5	25
Gahcho Kue	De Beers (51%); Mountain Province Diamonds (49%)	Canada	2015	NA	11
Renard	Stornoway (100%)	Canada	2015	NA	11
Mothae	Lucara Diamond (75%); Government of Lesotho (25%)	Lesotho	NA	NA	NA
Bunder	Rio Tinto (100%)	India	2016	NA	25
Brauna Diamond Project	Lipari Mineracao Ltda (100%)	Brazil	1Q15	0.2	7
Diavik Diamond Mine	Diavik Diamond Mines Inc. (NA)	Canada	2003	100 million carats of diamonds over its mine life of 16 to 22 years	16 to 22 years (currently in the 11th year)
Karowe Diamond Mine	Lucara Diamond Corp.(100%)	Botswana	2012	0.4	15
Lemphane Diamond Project	Paragon Diamonds Limited (85%)	Lesotho	2013	0.06	10
Star Diamond Project	Shore Gold Inc. (100%)	Canada	NA	1.67	12
Tirisano Diamond Mine	Rockwell Diamonds Inc. (74%)	South Africa	NA	NA	18
Wouterspan Diamond Mine	Rockwell Diamonds Inc. (74%)	South Africa	NA	NA	More than 10 years

*The list is not exhaustive and contains a limited number of projects

Source: Intierra database accessed 22 November 2013; Company Reports accessed 22 November 2013

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