RAPAPORT

The Right Way Forward

Statement by Martin Rapaport

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De Beers is moving forward in the right direction by reducing rough prices sufficiently to enable increased sales of rough diamonds and a resumption of diamond manufacturing activity. This is evidenced by an increase in De Beers rough diamond sales by 118% from $248 million in the tenth sales cycle of 2015 to $540 million in the first cycle of 2016.

While there is no official indication as to how much De Beers lowered rough prices, we estimate a drop of 7 to 10 percent in the current sales cycle following a decline of 15% in 2015. The reduction in De Beers rough prices includes the nominal lowering of price (i.e. reducing prices for specific boxes of rough) as well as improvements in the assortments within the boxes. By providing better assortments, De Beers can lower prices without reducing nominal prices.

So far, polished diamond prices have been firm with some improvements and the lowering of discounts for select sizes and qualities. It is important to note that the strength in current polished prices is the result of severe shortages due to a 40-50% reduction in diamond manufacturing during the second half of 2015. These shortages were created due to De Beers overpricing of rough diamonds. The current firmness of polished prices is the result of such shortages and not increasing polished diamond demand.

The outlook for polished diamond prices is mixed. While the U.S. Holiday season ended reasonably well, Chinese demand has not significantly recovered and will likely remain under pressure due to the sharp decline in the Chinese and global economic growth. The decline in Chinese and global equity markets is also reducing polished demand as consumers, who are invested in the stock and commodity markets, experience negative wealth effect.

To the extent that polished prices are currently supported by artificial shortages, it is possible that polished prices may decline as new production enters the market. It all depends on the level of demand. Such corrections of polished prices are a good thing, because it means that polished diamond prices are being adjusted by the market to reflect diamond demand, rather than De Beers' artificial supply-side price manipulations. It is expected that polished prices will increase as, and when, China recovers and the global economy improves.

<u>We encourage De Beers to maintain a consistent level of rough diamond supply at price levels that ensure reasonable sustainable profitability to diamond manufacturers</u>. De Beers must not repeat their mistakes of last year by overpricing rough diamonds that result in a sharp decline in diamond manufacturing, polished shortages and bullwhip effects that increase volatility and uncertainty. Frankly, the diamond trade has enough challenges matching supply with volatile and uncertain demand without De Beers messing up the supply side with unsustainable manipulations of the price and quantity of rough diamonds sold.

It should be clear to De Beers' management and the rest of the industry that De Beers must not try to control rough or polished diamond prices. They are in the business of mining and selling consistent quantities of rough diamonds at sustainable prices, not creating market manipulations that result in artificial shortages and long term damage to the diamond industry's infrastructure.

De Beers and the other mining companies are also strongly encouraged to embark on a comprehensive marketing campaign that promotes desire for generic diamonds. This is the right way to increase diamond demand and support sustainable polished prices. It makes sense for the mining companies to invest in creating diamond demand that will increase their profits. Without such investment in demand, the mining companies are simply throwing their money into a hole in the ground.

The diamond trade has no problem with De Beers making huge profits, as long as such profits do not come at the expense of reasonable and sustainable trade profitability. When De Beers increases advertising spend, they expand profitability for themselves and the trade. They move away from the disastrous zero-sum game they have been playing with the diamond trade. Increased advertising and promotion is the right way forward for the mining companies and the diamond trade.

<u>In the event that De Beers continues on a responsible path, we expect a healthy diamond market to emerge.</u> Polished prices will adjust to the realities of polished demand. There may be some short-term corrections as a return to normal supply levels confronts relatively weak global demand, but we expect the markets to settle down quickly as long as the supply side of the equation remains consistent and profitable. China and the rest of the world will improve and enter new periods of growth and development. As long as the diamond dream is kept alive demographics will support consistent demand. In our view the mid to long term growth outlook for the global economy is positive and the same is true for diamond prices and markets.

<u>In conclusion, we are not out of the woods yet, but we are headed in the right direction and it looks like the worst may be over.</u> 2016 has the potential to be a great year for the diamond industry as profitability and responsibility returns to the diamond supply chain.