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INDUSTRY REPORT

Diamond Prices 2016: A Polygon Industry Report

by Nathan Munn

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Slow diamond sales in China are often blamed for falling diamond prices.

DIAMOND PRICES ROUNDUP

Prices of polished natural diamonds fell by more than 10% between 2011 and 2015 according to IDEX, while the Zimnisky Global Rough Diamond Price Index shows that prices of rough [dropped about 11%](#) from Oct. 2014 to Oct. 2015. Neither trend shows any sign of turning around any time soon.

Sluggish diamond sales in China are generally blamed for the price drop, which is negatively impacting revenues and profits for the world's top diamond producers. However, slow sales in China are not the only reason for the ongoing drop in prices. Several other factors are contributing to downward pressure including the publishing of polished diamond price lists, increasing popularity of lab-grown diamonds, which tend to be about 30% cheaper than natural stones, and revelations of above-average diamond inventories held by some producers.

Low prices are also impacting the stock prices of publicly-owned producer companies. In July, Petra Diamonds announced that the company's FY2015 revenue had declined by 10% despite a 1% increase in sales, thanks to falling diamond prices and declining production at the Cullinan mine. These poor results led to the price of Petra shares falling from a high of \$210.80 in November 2014 to a [low of \\$79.55 on October 1, 2015](#) – a 62% drop. Net profit for FY2015 also fell 12 percent, to \$59.6 million (USD).

De Beers reported a 21% decrease in total sales and a 27% drop in consolidated sales volume for FY2015, and noted in a 2015 interim results report that “global demand for diamond jewelry is predicted to be stable in 2015”, but that “downside risks remain... related to diamond jewelry demand growth in China, as the country grapples with slower economic growth and asset price challenges.”

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Some analysts believe prices of rough diamonds could fall by another 15-20%.

Research from RBC Capital showed that a De Beers auction in July 2015 [generated only \\$200 million in sales](#), compared with \$750 million for last year's auction. In a memo to investors, RBC Capital said "...there is too much inventory in a market where demand is not robust". RBC also believes that due to the current supply glut, prices of rough diamonds could fall by another 15% before stabilizing.

HOW LOW PRICES AFFECT DIAMOND PRODUCERS

Besides the negative impact that low diamond prices can have on producers' stock valuations, when prices remain low for extended periods of time producers like Petra and De Beers are faced with a direct challenge to the viability of their core business model, which is the extraction and sale of mineral resources.

Just as low oil prices have prompted oil companies to scale back drilling projects in North America and elsewhere – resulting in thousands of lost jobs and millions in lost tax revenues - low diamond prices prompt producers to re-evaluate their spending and growth projections, usually leading to layoffs and cost-cutting measures. As producers see billions of invested dollars generating weaker and weaker returns, there comes a point where mines become too expensive to operate; workers with generous salaries become too expensive to employ; and commodity prices become too low to justify further investment.

It's a negative feedback loop that forces producers into fight-or-flight mode: default or survive. Defaulting involves shuttering operations completely, while survival entails eliminating costs and avoiding further risk. Neither option is attractive for investors, customers or workers.

Diamonds account for approximately 80% of Botswana's total exports.

INVENTORY & DEMAND

One of the strongest influencers of diamond prices is the amount of inventory held by producers. Lower stocks of inventory indicate scarcity, driving prices up; large stocks indicate a supply glut, driving prices down. In this sense it is beneficial for producers to keep their inventories as small as possible, to preserve the value of their stones.

The second major driver of diamond prices on the global market is demand. As previously noted, shrinking demand for luxury goods in China is contributing to lower prices. Slackening demand is now coupling with the drop in value of the Chinese stock market, which is expected to further depress prices as investors absorb the pain of losses in stocks and cut back on luxury spending and investments – two categories that affect diamonds directly.

EMERGING ECONOMIES

Some nations depend on diamond excavation as a major contributor to GDP and job growth, and for these countries a drop in diamond prices is a serious problem. Botswana, the world's top producer of diamonds, has been hard hit by the price drop: diamond exports account for around 80 percent of the country's total exports and generate 40 percent of government revenues and 33 percent of total GDP.

The value of the country's rough diamond exports fell by 15 percent in the first half of 2015, prompting Botswana's president to create an economic stimulus package to help the struggling economy. Botswana's future is inextricably entwined with diamond mining, as the country has a 15 percent ownership stake in De Beers and is also an equal partner in the Debswana mining company.

IMPACTS OF BANKING AND FINANCIAL POLICY

Banks are increasingly reluctant to finance the operations of diamond producers and sellers, due to concerns about regulatory compliance and transparency in an industry that is renowned for secrecy. Banks are under pressure from governments to stop lending money to companies that benefit from labor abuses and the mining of stones that do not comply with the Kimberly Process.

[In an interview](#) with Rapaport News, ABN Amro Diamond & Jewelry Clients CEO Erik A. Jens spoke about the current state of the diamond industry after the closure of the Antwerp Diamond Bank, saying:

“The biggest challenge facing the industry relates to consumer demand... I’m [also] concerned that the industry is being forced to cope with its own changes... In the old days, there was basically one rough diamond supplier. Prices were high but everyone made money as there was a consistent flow of diamonds at a consistent price. That’s not the case anymore... The industry acknowledges that it needs to improve its bankability and reputation because regulators still see the industry as high-risk.”

Jens also mentions in the interview that, in his opinion, the closure of the Antwerp Diamond Bank did not reduce the amount of liquidity available for diamond dealers, however other industry analysts disagree. In Jens’ view, the problem for the industry is not liquidity but *bankability*. This plain-spoken summary of the diamond industry’s current situation provides useful insight into just what top industry executives are thinking, and what sort of market conditions will likely unfold in the coming years.

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INTERVIEW WITH RB (Ritchie) Grampp Jr., BLUESTONE TRADING

What kind of diamonds do you trade in?

We trade in new, manufactured and second-hand recycled merchandise. White and colored diamonds, any size, from one and two-point [stones] or small melee that stores need for replacements, up to multi-carat, 10, 12, 15 carat certified diamonds. We also carry a variety of jewelry, whether its modern production line bracelets and necklaces, to big estate pieces, signed necklaces and signed pieces, and we exhibit at all the major antique jewelry and watch shows.

Prices of rough have dropped over the past year, while prices of polished diamonds have been in decline for the last five years or so. Have your prices been affected at all by these drops?

Sure, I think the whole marketplace has been affected by the softening of prices. At the end of the day, the marketplace has changed: you used to be able to buy diamonds from manufacturers at any discount or price, and you would be able to add an honest ten, fifteen or twenty percent margin onto it, and wait for the call, and eventually you would sell it - at any price, regardless of what it was.

But now, with technology advances and all the issues and credit crunches that Indian manufacturers are having overseas, now manufacturers are dumping stuff for so cheap, and there's so much information readily available, that [this is] no longer the case. The money is now made on the buy, and you have to buy things at the right price, and you also have to sell them very cheap. You can't just add a markup on something and wait for it to sell.

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The Antwerp Diamond Bank recently shuttered its operations. Some diamond industry analysts have said that the closure of the bank had a negative impact on the amount of liquidity available for diamond dealers, reducing their ability to get loans. Do you have any thoughts on liquidity in the diamond market?

I think that overall, it's a big problem. Unless you're well established and you have old money - so you don't have to worry about selling [diamonds] day-to-day to pay the bills - it's a big problem for a lot of people.

I think it's evident when you hear in the news, the international media, that all of these major companies are going under for 10, 20, 50 or 100 million dollars – [brand] names and people that we were brought up to think of as bigger than life – you know, times are definitely changing. I know a lot of people in the New York diamond district that are having liquidity issues, and they have to basically sell off everything just to make ends meet.

Do you deal with international clients often? How do they feel about the situation in the market?

I would say that we do a couple shipments a week internationally, and that [the situation] is scary everywhere, including at home. I look at my inventory, which is pretty healthy, and when I have 1 and 2-carat gorgeous diamonds laid out that I paid strong market price for – and I sell them at an honest margin – and I see some of these Indian manufacturers dumping goods for 20 or 30 percent cheaper than what I have my stuff inventoried for...

I think that international business is so bad for them that they have to sell at ridiculous prices. It's impossible for those prices to be profitable. At the end of the day, the cost of doing business whether you're sitting in Cleveland, Ohio, or Canada, or India or Belgium, is still the cost of doing business. So when you sell things below cost, there's only one reason you would do that, and that is to become liquid.

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What are your feelings about the Rap list and its place in the market today?

I have mixed emotions on it. I think a buying sheet is great overall, I think there's a lot of politics behind it, and I think a lot of people – rightfully so – sometimes get worked up when big adjustments are made on the sheet, positively or negatively, and how that influences people's businesses.

Do you think that the average retail diamond customer expects lower prices now as well?

I work very closely with a lot of retailers. At the end of the day, my father started Bluestone Trading in 1978 with [a focus on] the value of treating people how you would want to be treated, and I run the company the same way. We have a huge following of regular clients that come to us when they need something, or they need advice. And we treat them with respect, the way that we would want to be treated. We're not a New York company that wants to beat people up for every last dollar; we like to buy, sell and have a good time.

So to answer your question, from experience, I feel that there are a lot of over-educated – in the wrong way – consumers out there that are buying diamonds. It's evident when you see companies like Blue Nile and other monsters of the industry selling diamonds for ridiculous prices online with GIA certificates. People are so focused on what a piece of paper looks like that they lose track of what they're really buying, which is the diamond. This is why Blue Nile is able to sell phenomenal-looking certificates for ugly diamonds that have color problems, or they have black visible inclusions, or there's something wrong with the diamond, yet they sell them online for huge discounts because the average consumer thinks they know what they want – and they want to buy a piece of paper.

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Consumers seem to be more interested in perceived authenticity and storage of value, as opposed to the actual quality of the stone.

Correct. People should have knowledge of what they're buying, but they come to a jewelry store for trust, just like they go to a [particular] bank for trust, or a car dealership, or a realtor to buy a house. There's a level of trust and understanding that they're hoping to gain [by] using an expert's opinion.

People go online and they try to do their own research, and they think they know what they are doing because they spend a few hours reading online, when in reality they've never looked at a diamond before in their life.

Thanks to RB for taking the time to talk with us. You can visit Bluestone Trading at <http://www.bluestone-trading.com/>.