De Beers Foresees Pleasingly Normal 2017

Five-Minute Interview: Gareth Mostyn

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RAPAPORT... De Beers offered few surprises in its 2016 earnings, which were published on Tuesday and reflected what chief executive officer Bruce Cleaver called a "very pleasing year." Granted, growth was compared to the weak performance of 2015, as last year saw inventories across the rough and polished sectors returning to "normalized" levels. But De Beers revenue and earnings are closer to the robust levels they enjoyed in 2013.

Apart from its improved performance, the company reached a number of significant milestones during the year. It changed CEOs, launched the Gahcho Kué mine in Canada, raised its marketing budget to $120 million, expanded Forevermark beyond 2,000 retail locations, and forayed into generic diamond grading through its IIDGR division. The company is also testing new businesses such as a polished trading platform run by its auction unit, and a consumer buyback program.

In short, De Beers is now spread across the distribution chain as it seeks to support its core rough-diamond operations. This year, as it continues to develop each of those auxiliary businesses, the company is focused on driving production – with planned output of 31 million to 33 million carats, compared to 27 million last year – while advancing its marketing programs.

Rapaport News spoke with De Beers head of strategy Gareth Mostyn about the company's plans and some of the challenges facing the market.

Rapaport News: *You've provided a fairly bullish production outlook for 2017, as have other major diamond miners. Is there sufficient polished demand to support all the rough coming on stream?*

Mostyn: We recognize that the strong performance last year was only a result of the discipline that we brought across our business in late 2015 and through 2016. We're very much aware of the importance of staying close to our customers, talking to them about what they need in terms of production, working with them in order to supply according to demand.

Our production of just over 27 million carats in 2016 was not typical. We reduced production in the past two years in response to the challenging inventory positions across the industry.

But we sold a lot more last year. Together with our partners, we sold 32 million carats as our customers' rough and polished inventory became more balanced. We see the increase in production in 2017 as a shift back to normal levels.

Rapaport News: *Which of your operations will drive production growth?*

Mostyn: Most of the increase will come from Debswana [De Beers mining partnership with the Botswana government], and the Gahcho Kué mine in Canada, which we continue to ramp up after opening this past September.

In 2015, Debswana reduced production at the Orapa group of mines, which included putting the Damtshaa mine on care and maintenance. We rebalanced production to focus on the slightly higher-value Jwaneng mine. Debswana will look at production across all of its mines, including a review to decide when it will be appropriate to resume operations at Damtshaa.

We continue to invest in mine life extensions in Botswana with the Cut-8 expansion project at Jwaneng, from which we expect to start processing ore this year. Also in South Africa, the development of underground mining at the Venetia mine continues, and will be completed around 2022.

Rapaport News: *How has India's demonetization program impacted diamond sales?*

Mostyn: The demonetization program in November came as a surprise to us all. It clearly created turmoil across India, and given India's important position in the industry, it impacted the diamond market as well. We responded by giving additional flexibility to sightholders in the final sight of 2016.

Our sightholders are less affected than some of the smaller companies, since they're not cash businesses, they're well-governed, and are therefore better equipped to weather the storm than the smaller companies. We were certainly very encouraged by the level of rough demand at our first sight of 2017.

The program was also a shock to the retail market in India, where many transactions are made with cash, and it will take time for that to normalize. In the long term, we're very positive about retail demand and the emerging middle classes in India. We also make sure our Forevermark marketing programs focus on India, and we're working with the Gem & Jewellery Export Promotion Council (GJEPC) to stimulate consumer demand there.

Rapaport News: *What impact do you expect synthetic diamonds to have on the natural-diamond market?*

Mostyn: There's clearly an avenue for disclosed synthetics to be sold to consumers, and over time, synthetics will no doubt find a place in the market. We see that being typically in cheap costume jewelry. As production techniques develop, the cost of synthetics will decline, and it will evolve into a very different market at the very cheap end of the spectrum.

We take synthetics very seriously. We must be absolutely clear that diamonds are a rare, precious and finite resource. The diamonds we mine were created millions of years ago. They're probably the oldest thing any of us will ever touch.

Synthetics have none of those characteristics. They're not rare, they're not precious, and they're not finite. As a result, they're not a substitute for diamonds in symbolizing life's most precious moments.

With that in mind, it's important that consumers always have confidence in what they're buying.

We're very focused on the risk of undisclosed synthetics getting into the natural-diamond supply chain. We spend millions of dollars every year on programs to develop detection machinery to be able to identify any type of synthetics and instill confidence in consumers for the product they're buying.

Rapaport News: *What's your marketing budget for this year?*

Mostyn: We expect it will be around the same level as last year at $120 million. In addition to our own proprietary marketing with Forevermark, we are investing more in partnerships, such as with the Diamond Producers Association (DPA), the GJEPC, and last year we worked in partnership with Signet in the U.S. on the "Ever Us" campaign.

Rapaport News: *What is De Beers expecting from the U.S. this year given the current economic and political climate?*

Mostyn: The U.S. is by far the biggest market for diamond jewelry, accounting for nearly half of global demand. The U.S. also continued to generate the most growth for the industry in 2016, which is quite remarkable given that it's the largest market.

As we look at 2017 and beyond, it's really all about that U.S. consumer, and how the U.S. economy is going. We don't particularly focus on political trends, but we absolutely do focus on U.S. consumers and marketing to them. All the fundamentals are strong, and there's no reason to doubt that growth won't continue.