EQUITY RESEARCH

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Diamond Industry Outlook

Global Growth is the Major Driver

Global jewellery demand the key to diamond prices

Rough Diamond Prices firm: Recent tenders by the diamond miners have resulted in relatively strong prices with year-to-date increases of up to 10%. Companies ranging from Petra Diamonds to Dominion Diamonds and Lucara all report improving results from sales, and Russian company Alrosa predicts rough will close 2013 about 10% ahead. Our view is that prices could drift down somewhat through the summer with a small pick up in Q3/Q4. On the basis that global demand improves in 2014 on the back of continued improvements in the US economy and better jewellery demand in China, we see potential for a further rise of ~10% for rough. As always, however, rough prices will be influenced by the margin that is available to polishers and the provision of liquidity in cutting centres.

Some risks to the long-term thesis: It has become a common view that rough diamond prices will be firmly underpinned by a scarcity of new-mined production. That new-mined output is likely to grow slowly, at best, is relatively clear, in our view. We also believe that demand for diamond jewellery will grow on the back of increasing urbanisation in China and a recovery in the US. In the case of the US, signs are increasingly positive for the economy. There are some risks, however, including slower-than-hoped offtake in China as the new leadership makes its impact felt on the economy. Other risks which exist include the threat from synthetics and the increasing availability of second-hand diamonds in tougher economic times. Our view is that these latter two risks should not materially impact the market in the medium-term.

Currency benefits/labour worries: Producers are starting to feel the benefits of weaker currencies, particularly in South Africa, which should improve margins. An offset for companies in South Africa is the prospect of a volatile labour environment in the near-term until the wage negotiation season is over.

New marketing channels begin to emerge in rough: Next month sees the first sale of Botswana diamonds by state-owned Okavango. Other changes to the way rough is sold are likely including more direct deals between miners and retailers.

Investment thesis still favours those in production: We continue to favour investment in those companies which are in production (Petra Diamonds and Dominion Diamonds) and those which are near to production and should be able to fund new developments (Mountain Province and Stornoway). The risk for developers remains access to funding and here we see companies resorting increasingly to debt and offtake deals alongside equity. Projects that will be funding in the next year include Gahcho Kue and Renard.

Priced as of prior trading day's market close, EST (unless otherwise noted).
All values in USD unless otherwise noted.
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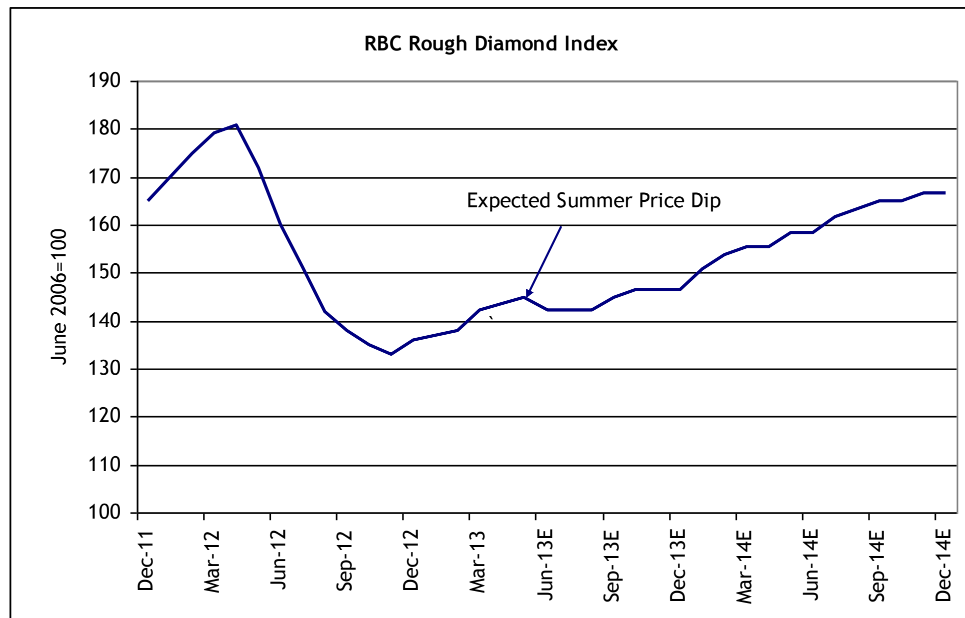
Rough prices steady but concerns in short term

As the northern hemisphere moves towards summer, rough diamond prices are likely to struggle somewhat as diamantaires trim demand ahead of the holiday season. In addition, after price rises of 5%-10% so far this year there are some complaints that rough prices do not leave much in the way of profit for the polishers. Add to that the determination of many banks to tighten up on lending to the sector and we believe that rough could well lose a few percent before stabilizing into the second six months. In our view, provided global growth continues to stabilise, rough will probably end 2013 more or less where it is now.

Exhibit 1: Rough Prices Sluggish Near-Term



Source: RBC Capital Markets' estimates

Ahead of the summer season, the Diamond Trading Company (DTC), a subsidiary of De Beers, closed its fourth sale of the year (called Sights) with total rough moved of about $610m, which included a small price increase, we believe, of 2%-4%. Our expectation is that DTC first-half sales will probably be around the same level as H1 2012 but H2 will be higher as De Beers should have increased availability of rough. Hence, we forecast a small increase in De Beers' annual sales of a few percent.

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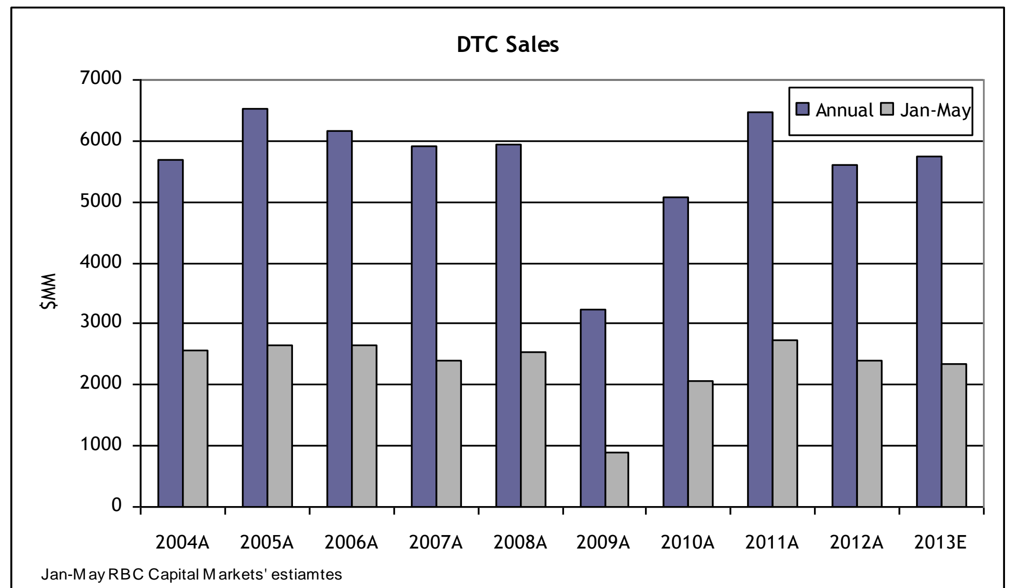
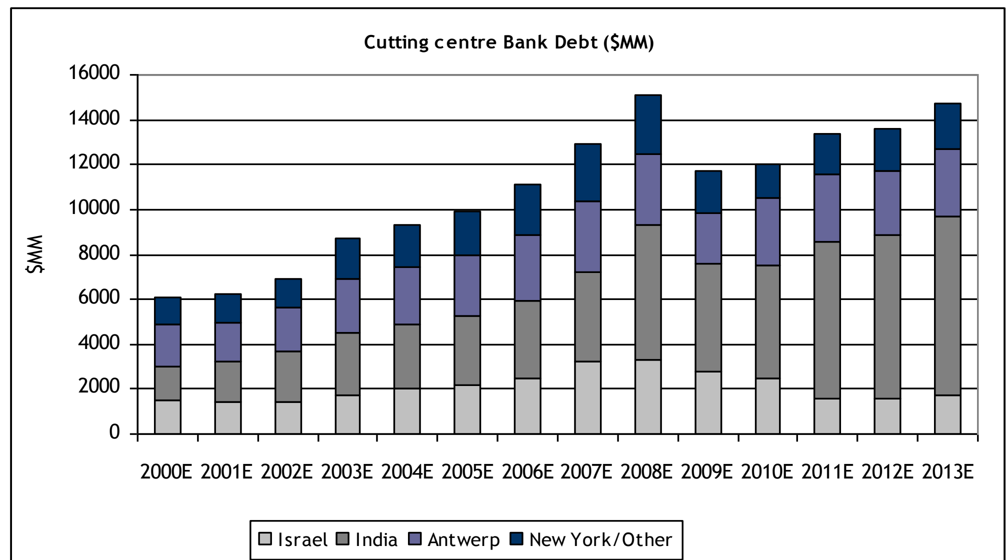
Exhibit 2: DTC Annual and Jan-May Sales



Source: Company reports and RBC Capital Markets' estimates

The DTC price increase is not that surprising given the way rough has been moving in the major cutting centres with companies such as Dominion Diamonds (Ekati tender), Petra, Gem and Lucara all reporting improved realisations; Lucara's large goods tender ends on May 22 and we would expect strong prices. Diamond bankers will, however, be slightly less pleased with the DTC price rise given they would like to see more margin in manufacturing to help reduce cutting centre bank debt which is running a high level of ~$15bn. As one banker commented to us recently, "total debt to the diamond sector is up around 75% in the past 10 years but the value of rough production is pretty flat".

Exhibit 3: Cutting Centre Bank Debt



Source: RBC Capital Markets' estimates

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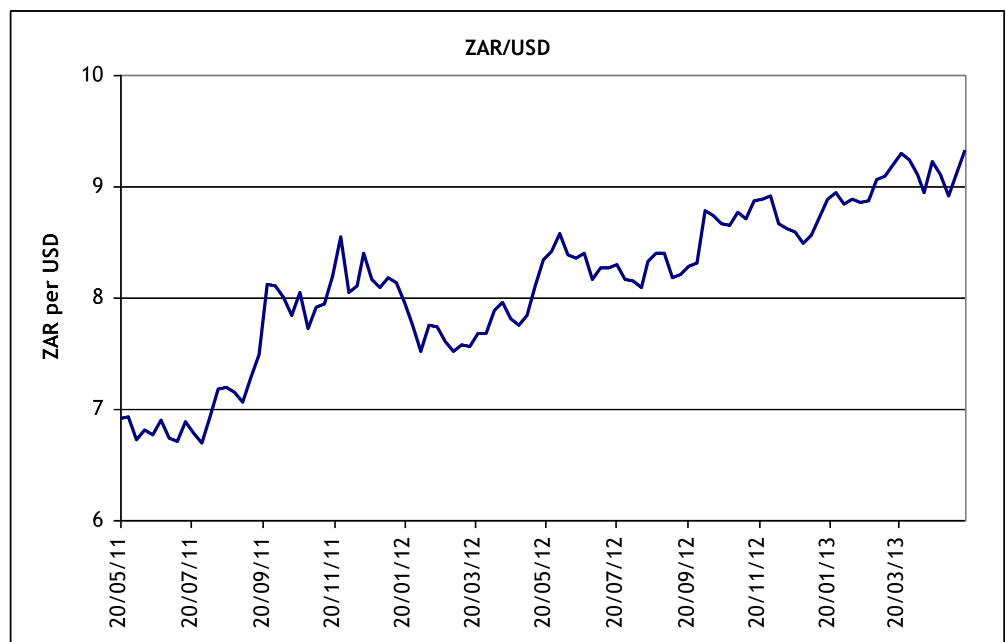
Prices and currencies help miners

For the miners the outlook is for modestly better prices over the course of 2013, while margins should also benefit from weaker currencies in producing countries. This is particularly true of South Africa with the rand (ZAR) weakening materially against the US dollar (USD) since Q3 2012. We expect recent labour unrest on the platinum mines to keep the currency under pressure as portfolio flows are likely to be weak or negative. For a company such as Petra Diamonds, which has most of its mines in South Africa, the weaker ZAR translates into lower USD costs which should benefit margins for a company that sells a product priced in USD. Other companies which should benefit include Gem, Lucara (not covered), Rockwell (not covered), Firestone (not covered) and DiamondCorp (not covered), though some of the gain may be offset to the extent capital equipment is imported and labour rates are pushed higher in this mid-year negotiation period.

Exhibit 4: ZAR weakens against USD



Source: Bloomberg

Rough prices should improve in 2014

For 2014 we forecast an improvement in rough prices of around 10% based on increasing prospects for better economic conditions in the US and China. Again, next year we have modeled a slow mid-year and assumed no speculation in demand on the basis that bankers will be more cautious in the advancing of credit to the sector given a high level of bank debt at present. Drivers of our expectation of better prices in 2014 are improving confidence in the US (as seen in confidence indices and housing permits) and signs of some improvement in jewellery demand in China. In addition, rough inventories are low (mostly in Russia and held by the Treasury) and we do not see any material growth in new-mine output.

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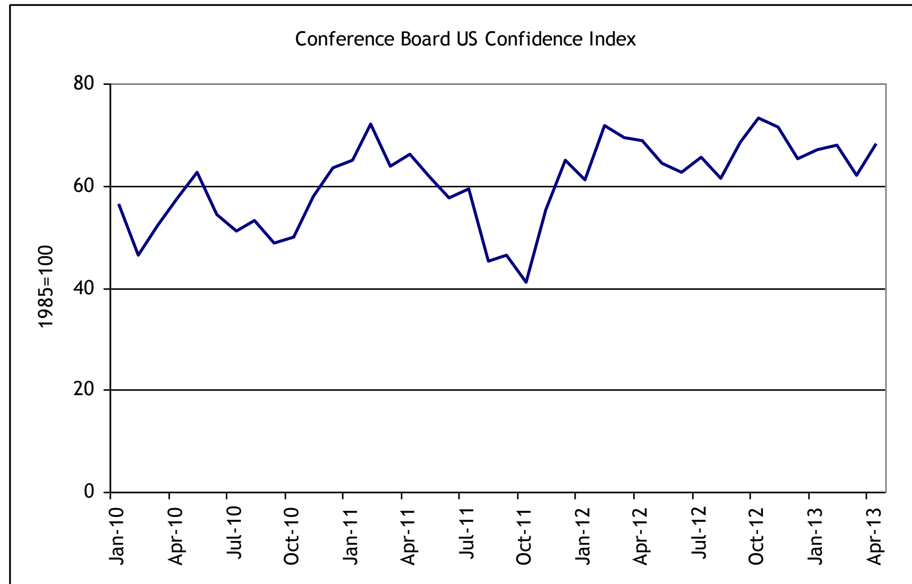
Exhibit 5: Conference Board US Consumer Confidence Index



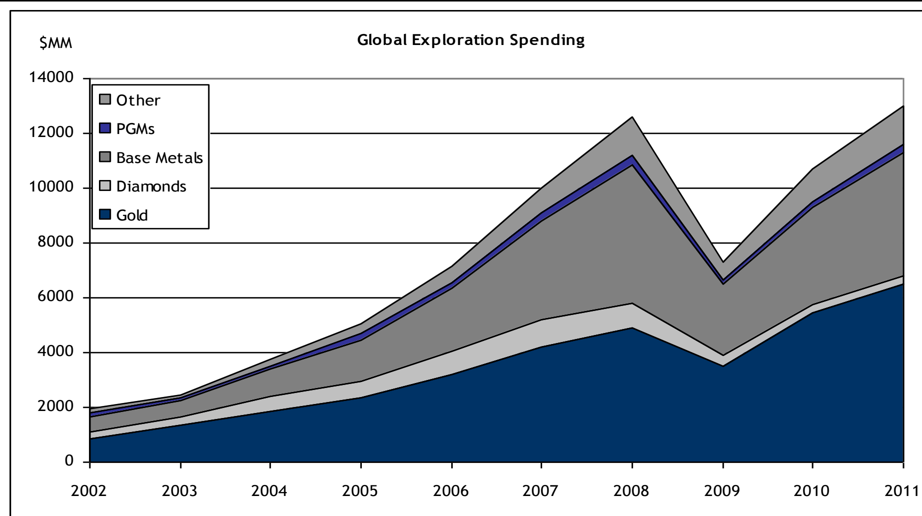
Source: Conference Board

There are Risks in our Forecast

Supply side looks tight

The major risk to our rough price forecast is slowing economic growth; in other words jewellery demand rather than supply given a paucity of new deposits being developed globally. The fact that BHP Billiton has exited diamonds and Rio Tinto looks set to follow with a disposal of all or part of its diamond portfolio underpins our view that new supply growth will be constrained. Essentially the only large companies left to spend on expensive diamond exploration are De Beers and Russian producer Alrosa, and even De Beers is spending far less than it has historically. For juniors, the decade-long exploration search is often unaffordable.

Exhibit 6: Exploration Spending



Source: Metals Economics Group (MEG)

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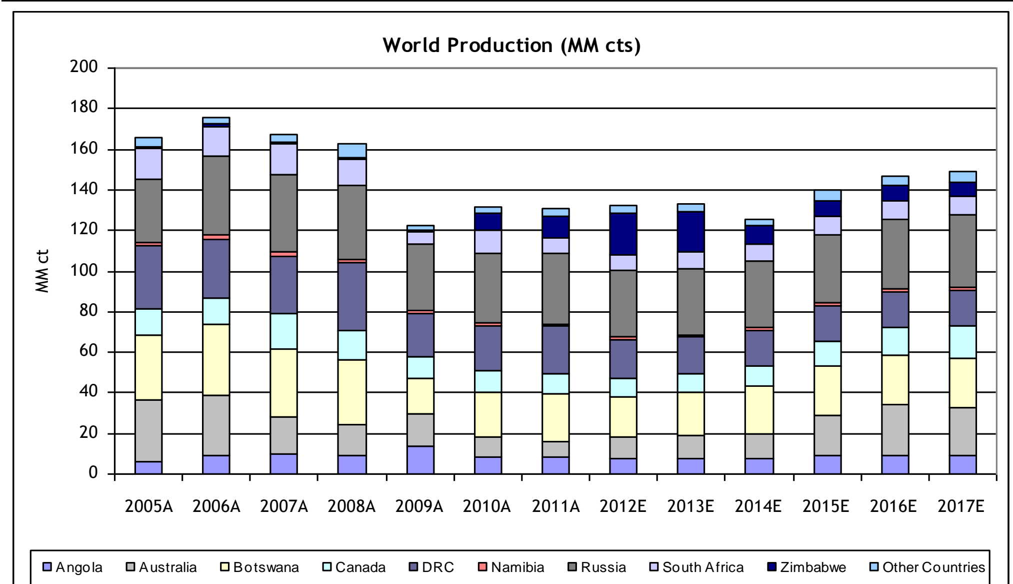
With little likelihood of any significant "return from the drill bit", major new projects will likely be scarce. Other than a blip upwards in carat output (not as significant in dollars) as Rio's Argyle mine in Australia ramps up under ground, there are likely to be few additions to global output over the medium term; Gahcho Kue in Canada (Mountain Province) and Grib in Russia (Lukoil) are the largest, and even these two projects will not fully offset the decline in other older mines. It is also worth noting that Ekati (Dominion Diamonds), Diavik (Rio Tinto and Dominion Diamonds) and Argyle (Rio Tinto) are all expected to run out of resources within the next 10 years or so.

Exhibit 7: Global Diamond Production



Source: Company reports and RBC Capital Markets estimates

Demand is the Key

It is the demand side of the diamond equation that should underpin rough prices. While much of the diamond sector's upside is attributed to China it should not be forgotten that the US remains the largest market for diamond jewellery. This is a positive since the US economy appears to be improving. In addition, while the US is a developed market, the diamond engagement ring (DER) culture is well established and there is still, we believe, significant upside for the diamond jewellery market as the economy revives.

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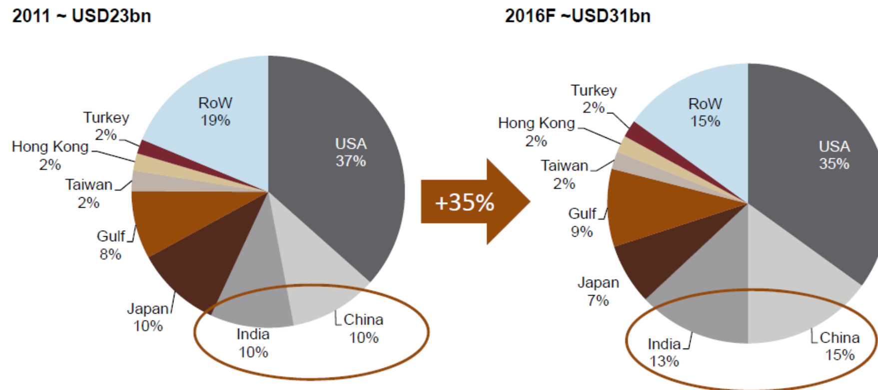
Exhibit 8: Diamond jewellery sales (polished wholesale prices)



Source: De Beers, November 2012

China's growth trajectory probably carries more risk in the near-term. While the DER culture is gaining traction and leading jewellery chains such as Chow Tai Fook (not covered) have ambitious expansion plans (up to 1,000 new stores planned in the next decade or so), the change in leadership in the country has caused a pause in the upward momentum. Medium term the growth should resume, we believe, given urbanisation trends with, for example, McKinsey projecting ~220 Chinese cities of more than 1m people by 2025 compared with around 150 now.

Beyond the US and China, India looms as a large potential market, though it does appear to be more difficult for diamond marketers to gain traction. Even so, according to De Beers India could account for 13% of the global diamond jewellery market by 2016 compared with an estimated 10% in 2011.

Risks to the Supply and Demand Thesis

The view that rough diamond supply will lag potential demand and underpin firm prices is virtually universal with De Beers and Rio, among others, posting charts on their websites showing the potential scarcity of new-mined rough. But, there are some reasons to question some of the underlying assumptions. Among the risks to the view that rough prices will continue to be underpinned by firm demand, as we see them, are:

China's love affair with diamonds

It appears that China is adopting a diamond jewellery buying culture in the way that Japan did from the late 1960s. Cultural changes and government policy could slow the development of the jewellery market in the same way that the so-called "gift-giving" of the likes of watches has seen sales fall in China. While Japan's acceptance of DER for marriages grew the sale of diamond jewellery through the 1970s and 1980s, the slowdown in that economy has seen the proportion of first-time brides who receive DERs fall from ~75% to around 60% now. It is arguable that without the massive marketing that De Beers directed at building demand for DERs and diamond jewellery generally (the company used to spend ~$150m a year on marketing), this demand could be lost forever.

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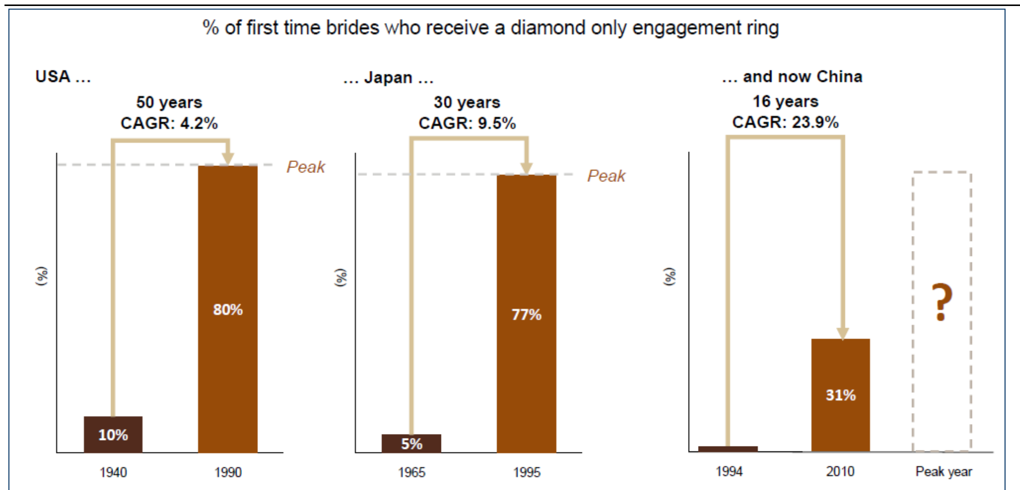
Exhibit 9: Diamond Engagement Ring Demand



Source: De Beers

The Threat from Cultured or Synthetic Diamonds

The ability to manufacture diamonds in a factory has increased significantly since General Electric (starting in 1955) and later De Beers developed the technology using the High Pressure High Temperature (HPHT) process. Since then other processes have been developed including Chemical Vapour Deposition (CVD), and commercially-available man-made stones are now readily available from companies such as Gemesis and Apollo (both in the US) and from makers in Russia. An internet search shows many sources of commercial synthetic gems for use in jewellery.

Exhibit 10: Synthetic Diamonds from Gemesis

Source: Company reports

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There are two important issues surrounding manufactured diamonds. The first is the extent to which they can take market share from natural stones; the other is whether factory-made gems will be, or have to be, disclosed. While the emotional appeal of natural diamonds is likely to remain well above that of man-made gems, our view is that cultured diamonds will gain market share, particularly in commercial jewellery. But we do not see this as a major threat given the potenital shortages in some areas of the diamond market and the efforts of the diamond labs to ensure that synthetic stones are certified as such. However, there is increasing risk that factory-made stones will enter the market without being disclosed; there have been instances of synthetics being discovered in parcels of natural diamonds. While the threat of synthetics is minimized by efforts of the major gemological labs and De Beers (supplies equipment to identify the factory gems), we expect to see increasing instances of these stones finding their way into the diamond manufacturing centres.

Recycled Diamond Jewellery

In the past year or so, the subject of "second-hand" or recycled diamonds has become a discussion topic. Some forecasters (e.g., Tacy in Israel) suggest a massive threat from second-hand gems as the ownership of diamond jewellery has proliferated. In addition, in tougher economic times the sale of surplus items such as diamond jewellery is likely to increase. For jewellery manufacturers, second-hand polished at the right price is less risky than rough because the quality is easier to gauge. Again, an internet search will disclose several sources of recycled diamonds including auctions held by the Rapaport Group in New York. At present the supply of second-hand goods in the US, in particular, is relatively strong, but its importance may wane as economies recover. Our view is that these stones will gain some share of the market, but as developed economies grow in importance the demand for rough will make the threat relatively insignificant for a long while yet.

Other key issues for the industry

The emergence of new marketing channels for rough

Changing marketing channels for rough could see some movements in rough in the near-term which may not reflect underlying demand. The biggest of these will be when the Botswana government starts selling 12% of Debswana's rough as of June this year. Competition to get on the list of customers for Okavango's (government) online auctions could lead, initially anyway, to some distortions in rough prices.

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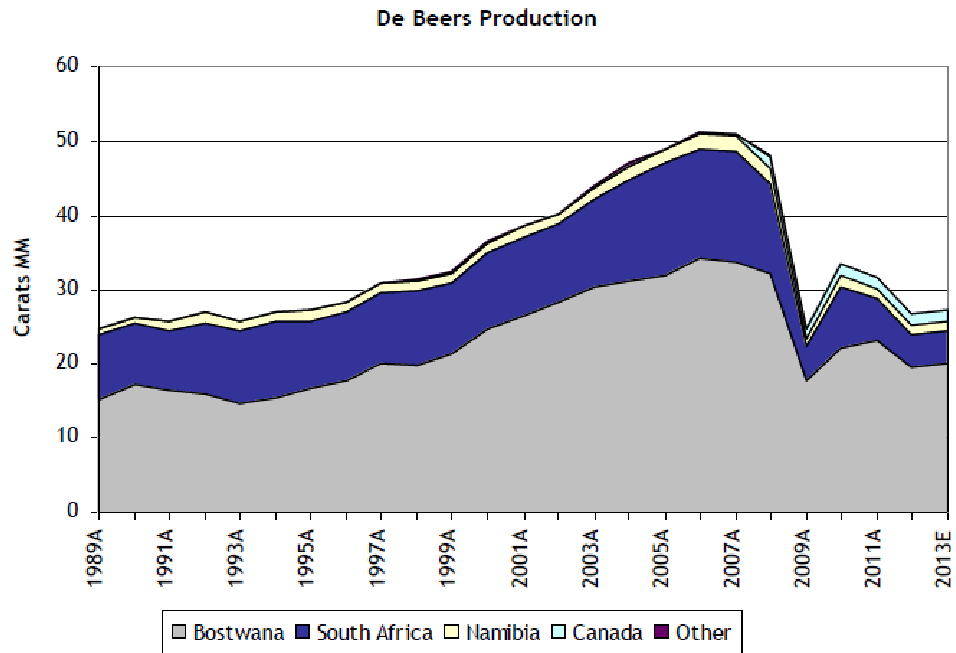
Exhibit 11: De Beers Production



Source: Company reports and RBC Capital Markets' estimates

When De Beers and the Botswana government renewed the Debswana contract in 2011 the government gained the right to market 10%-15% of the rough itself. Okavango intends selling this rough using a similar system to that employed by BHP Billiton (spot auctions with some term sales). We expect that competition from diamantaires to get on the Okavango auction list may see prices bid on the high side and this may pressure De Beers, which sells the same run-of-mine goods, to nudge prices higher.

Longer-term the way in which De Beers sells its diamonds may also change from the current 10x-a-year Sight system where the company offers its production to a selected range of global diamantaires. The way in which the sales may take place will be dictated to some extent by the success that Okavango has in marketing its share of Debswana output, and also on the eventual contract which emerges between De Beers and Botswana when the present 10-year agreement expires at the end of 2020.

As the diamond bankers trim growth in their advances to the industry, other changes can also be expected to the way in which rough is sold. Our view is that there will be increasing numbers of direct deals between diamantaires and the mines, and between the mines and retailers. Already Tiffany, for example, has offtake agreements with Ellendale mine in Australia, Lace in South Africa and the Koidu mine in Sierra Leone. In the latter two, the offtake agreements are part of financing deals. Russian state-controlled Alrosa also has forged direct sales deals with Indian cutters/polishers and retailer Chow Tai Fook. We believe these alternative arrangements will be needed as the traditional bankers' role in funding the diamond sector transforms (see report titled "Diamond Financing is Not Forever" dated 19 March 2013 – link here).

For diamond developers offtake or "streaming deals" may well become a key part of funding new projects along with increased use of debt finance and, possibly, the use of private equity since traditional equity is more difficult to tap at present.

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Labour stoppages may weigh on production

South Africa is going through a difficult phase in labour relations at its mines. Strikes, violence and some deaths at Marikana in the platinum belt last year, as well as increased competition between two major labour unions to represent workers, is creating a volatile labour market in South Africa. While most of the strikes were in the platinum and gold sectors, there were sporadic stoppages in diamonds too with Petra suffering short stay-aways at Kimberley and Cullinan.

The wage-bargaining season is beginning in South Africa at present and indications are that it will be a difficult period as the NUM and Amcu unions jostle for position in the wake of the violence, which flared up last year. We are concerned that while labour relations in diamonds remain relatively stable volatility may flow over from the platinum and gold negotiations.

Conclusion: Medium-term Outlook Sound; Short-term Some Rain Clouds

Overall we expect rough prices to close 2013 around current levels with the potential for some weakness in the seasonally slower summer holiday period. Our forecast for 2014, albeit early, is for an increase of around 10% in rough prices on the basis that US growth continues and China's demand picks up further.

Near-term risks for diamond prices revolve around global growth and the ability of the diamond centres to fund their inventories. Medium-term we see several potential issues facing the diamond market, including synthetics and second-hand diamonds. We do not consider either of these to be major threats.

Overall we retain our investment position which favours companies in production such as Petra Diamonds and Dominion Diamonds, as well as companies with near-term development decisions which should be able to access sufficient funding, such as Mountain Province and Stornoway Diamonds.

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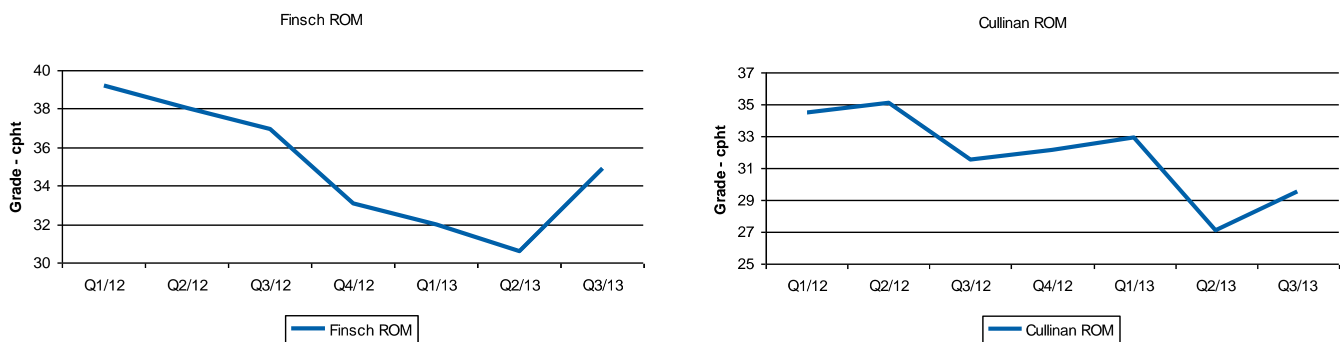
Petra Diamonds Ltd (LSE:PDL, £1.03, Outperform, £1.60 Price Target)

Key drivers: Grades, expansion project and debt headroom

Grades in focus after improvements in Q3

The company has flagged that grades (particularly at the key Cullinan and Finsch mines) will be weak in the next couple of years as mining predominantly takes place in diluted ore bodies. In the recent Q3 IMS we saw a q-o-q improvement in grades at Cullinan and Finsch that was encouraging, although we would expect grades to remain volatile until undiluted ore is accessed as new caves are developed. The charts below highlight improvements at both Cullinan and Finsch (although grades remain below recent levels). With expansion projects coming on line at Finsch (FY15) and Cullinan (FY16), we expect to see marked improvements in grade and production in due course, with a benefit on margins.

Exhibit 12: ROM grade profiles at Finsch and Cullinan



Source: Company reports

Expansion projects underway and on track

Petra is in the midst of a major capex program with expansions at Finsch, Cullinan and Koffie, along with a ramp up of operations at Kimberley Underground. At Finsch, plans to increase production to 1.9mct/yr by FY18 continue; the company has been reviewing its capex estimates and has incorporated plans for a Rail-Veyor conveyance system, which is expected to save capex and improve ore handling. At Cullinan, plans to increase production to 2.4mct/yr by FY19 continue in line with expectations. Finally, the underground development of Koffie continues on time and on budget, with production increasing to 100kct/yr by FY16. We expect to receive an expansion update from the company in due course.

Headroom remains a focus

Petra's expansion projects are capital intensive and funding will remain an area of focus for investors as the company nears peak-capex. We estimate Petra's capex at ~$200m in FY13, increasing to ~$230m in FY14 and $170m in FY15. This reducing profile should continue with capex beginning to drift off in FY18 as expansion projects are completed. Management continues to stress that Petra is comfortable with the funding position, which was refinanced in November 2012. Petra ended March with cash of $35m, diamond inventories of $40m and debt of $123m; headroom was $111m. We estimate Petra ends the year with $68m of available headroom; the lowest amount of available headroom in our forecasts is $48m, at end-June 2015 (although we still forecast cash at bank of $37m). As an aside, Petra could see additional cashflow benefits through a possible sale of the Fissure Mines (although no acceptable bids were received during the recent sales process) and value uplift from the sale of high value stones (such as the recently recovered 25.5ct blue from Cullinan).

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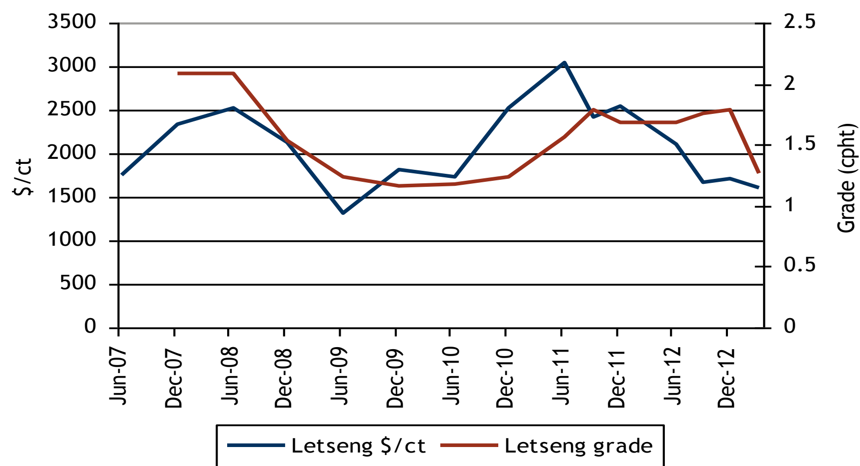
Gem Diamonds Ltd (LSE:GEMD, £1.28, Sector Perform, £1.70 Price Target)

Key drivers: Prices from Letseng, breakage and capex

Prices from Letseng

Gem has seen continued weakness in realised prices at Letseng, with Q1 2013 prices reaching a near-three year low at $1,599/ct - a marked fall vs. a record high of $3,052/ct in June 2011. While the market for large rough has been slower to recover than some other categories, Gem has also been impacted by a lack of Satellite pipe ore, which typically contains higher value stones (valued at $2,900/ct-$3,600/ct). The company expects to mine its entire FY13 quota of Satellite pipe ore (typically ~25% of total ore mined) in H2, which should lead to some improvement in grades and prices.

Exhibit 13: Prices and grade at Letseng – recently weak



Source: Company reports

Diamond breakage should reduce with management efforts

Reducing diamond breakage has been a key part of management's recent strategy, comprising one of the elements of Project Kholo. We believe breakage could result in a loss in revenue of ~$50m annually. Although Kholo has been slowed in light of market conditions, addressing breakage remains a focus, with Gem announcing the replacement of secondary crushers at plants No 1 and No 2. We expect this small ($4m) project to be completed by end Q2, and should see positive impacts in reduced breakage, increased recovery of larger stones and subsequent cash flow improvements.

Capex - cash flow is sufficient to cover but higher prices would be helpful

The impact of weaker prices, breakage and spending on Ghaghoo has seen Gem's cash position fall from $159m at end December 2011 to $71m at end-December 2012; we forecast a further reduction in cash in H1/13, taking cash to $50m. In light of a difficult environment, Gem has slowed the Kholo expansion at Letseng, which, in our view, is an value-accretive project. The company continues to progress its Ghaghoo exploration project in Botswana, for which we hold no value in our NAV (we forecast capex of $35m this year). Commissioning of the 720ktpa plant is due to commence in Q2/14. It is not yet clear how the full Ghaghoo project will be funded. Overall, we forecast FY13 capex of $92m (including capitalized waste of $34m); in our view, the company has sufficient funds to complete its near term capex requirements and has a further buffer in the form of a undrawn debt facilities of ~$50m. A key to continuing projects, however, is higher prices.

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Dominion Diamond Corp (NYSE:DDC, $15.20, Outperform, $21 Price Target)

Key drivers: Ekati 43-101, Diavik upside, Potential M&A?

Ekati NI 43-101 – the last piece in the puzzle?

DDC completed its $550m acquisition of the Ekati mine from BHP Billiton in April; since then we have seen the release of a reserve and resource statement, which helped provide some initial colour on operating rates and forecast diamond production. However, as certain parts of the Ekati ore body had not been proved up by previous owner BHP, DDC was unable to provide a detailed mine plan. The company has since published guidance for Ekati from the date of acquisition to the end of CY13 - it expects sales of 1mct, driving revenues of $365m. Included in this figure is the sale of ~$70m of the ~$135m inventory acquired with Ekati. Dominion expects to release a NI 43-101 by the end of May, which we would expect to lay out a forecast for ore mined, production, sales, costs, capex and prices.

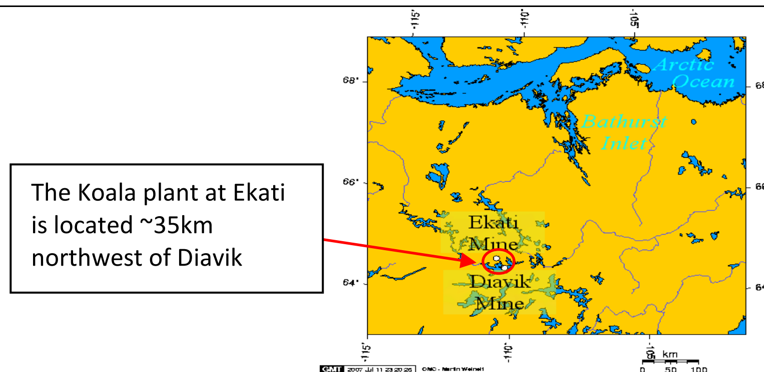
Diavik Upside – raising forecast production by 10%

DDC announced in its Q1/CY13 production release for Diavik that the mine was running 39% ahead of plan, driven by an improvement in grades vs. forecasts. Management had noted on its Q4/13 earnings call that there was possibility for a further 600-700kct should an additional 200kt ore be accessed. While the increase in production guidance does not come as a great surprise to us, it does add to value.

M&A –Remaining 60% of Diavik on management's hit-list

Management noted in its Q4/13 earnings call that DDC had the "headroom to undertake a transaction with Rio Tinto on Diavik should that be available at the right price". This comment was driven by the $750m received from Swatch for the luxury brand ($553m of this was paid to BHP for Ekati and small additional fees will also be paid on the transaction) and a recently arranged $640m credit facility (which had been planned for Ekati). We believe an acquisition of Rio's 60% stake in Diavik would make sense depending on price. Combining the mines' processing plants and administrative functions could exploit synergies; in addition, the positive free cash flow from both mines (post the completion of ~$250m Misery capex at Ekati) would provide funds to help progress development options at A-21 (Diavik) or Jay (Ekati), should the latter prove economic. A potential transaction with Rio could be complicated if Rio decides it wishes to sell the portfolio in one parcel.

Exhibit 14: Map of Ekati and Diavik – the synergies are there to be exploited



Source: commons.wikimedia.org

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Mountain Province (TSE:MPV, C$4.97, Outperform, C$6.00 Price Target)

Key drivers: Permits, New 43-101 statement and drilling results

Gaining permits

Earlier this year JV partners De Beers and Mountain Province spent $32m to transport early construction equipment up the Ice Road to Gahcho Kue, effectively kicking off the start of construction of a new diamond mine. Further progress will come as land use permits are obtained; we believe this should happen in H2. The next important milestone will be the receipt of water permits, which are expected early in 2014. Given success in the permitting, this should see formal start to building the mine in Q2 2014. Anticipated completion of the mine is mid-2015 at a rate of 4.5m ct/year.

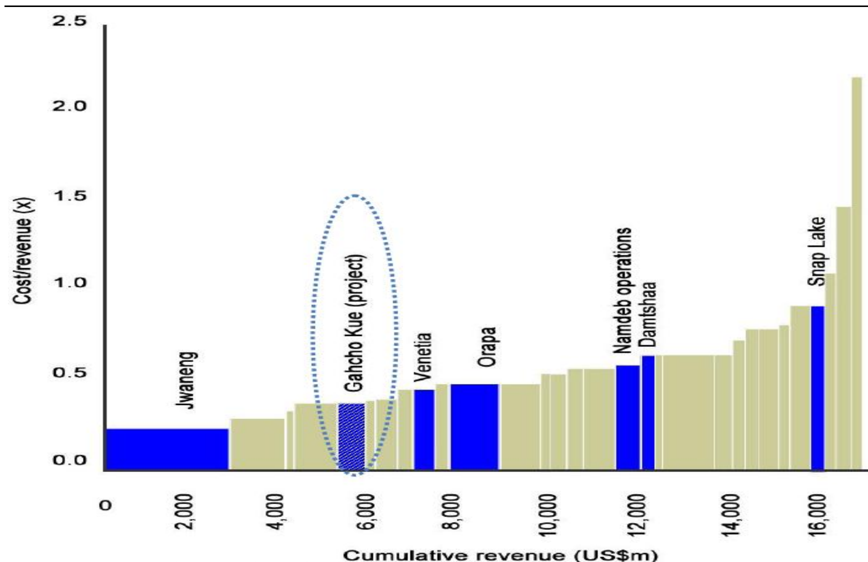
Waiting for resource upside

Before mid-year year we expect the publication of a new 43-101 resource statement for the deeper parts of the Tuzo kimberlite (Tuzo Deep); Mineral Services Canada was retained to complete this work earlier in the year. This should, we believe, detail additional mineable ore from 300 metres to 564 metres. Our view is that Tuzo Deeps could add significantly to the life of mine; perhaps taking it to at least 20years from the proposed 11 years. The positive implications of a larger 43-101 resource does not include any potential for additional mineable ore that might come from the company's exploration drilling programme in land surrounding around the mine property.

Exploration upside

A JV project with De Beers to advance exploration around the Gahcho Kue kimberlites started in early April. After a ground gravity survey the partners identified 10 targets for drilling. Success would add to the investment thesis for this developing producer.

Exhibit 15: Gahcho Kue's position in the profit curve



Source: Company reports

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Stornoway Diamonds (TSE:SWY, C$0.60, Outperform, Speculative Risk; C$2.05 Price Target)

Key drivers: Completing Road, Additional Ore, Project Finance

Completion of road to Renard

One of the critical time lines in the development of the Renard diamond mine has been the completion of the road north from Temiscamie to the Foxtrot site, which hosts the Renard kimberlites. The Quebec government voted funds to start the project in 2011 with anticipated completion by mid-2013 to allow mobilization to the project site. Earlier this year a new arrangement was concluded that sees Stornoway taking responsibility to complete the final 97km of the road to site, with funding coming from a loan from the government. This means that completion of the mine for ramp up mid-2016 should be possible provided all the funding can be put in place.

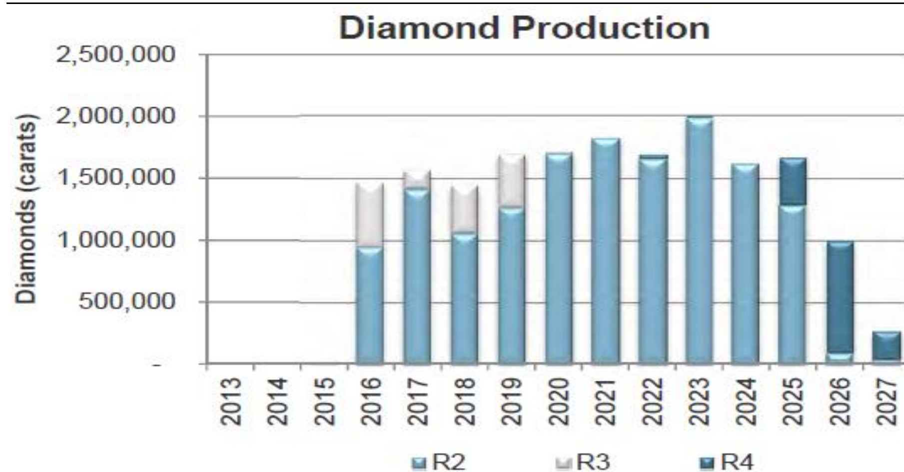
Additional resources are available

After an optimized feasibility study (FS) in January 2013 Stornoway has reduced slightly its budgeted capex to build the mine on the Renard ore bodies to an initial C$752m (previously C$802m) with opex costs 5% higher at a forecast C$57.63/t. In addition, the company has recently completed an independent evaluation of diamond prices including on the R65 ore. While the optimized FS detailed a C$392m after-tax NPV (7%), we believe that the figure should be significantly higher as inferred resources are processed.

Arranging the funding

While several permits are still to be obtained, the major task now is arranging finance to start ordering long-lead time items to start construction in 2014. Given the difficulty of raising equity finance for projects at present, and the size of the capital requirement in relation to the market capitalization of the company, Stornoway is examining several options including debt finance (the Quebec government as a major shareholder has committed funds already), offtake agreements for rough diamonds and equity. The company expects to arrange financing in the next two quarters.

Exhibit 16: Forecast Renard Production Profile



Source: Company reports

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Lucara Diamond Corp (TSE:LUC, Not Covered)

Key Facts: Karowe Mine. Diamond prices, Large Diamonds

Corporate facts

Lucara is a Canadian-listed diamond company (also listed in Botswana and Sweden) with two projects, a 100%-owned operating mine in Botswana (Karowe) and a 75%-owned trial mining project in Lesotho (Mothae). The Karowe mine was bought from De Beers and the then-named African Diamonds before development.

Lucara (which is part of the Lundin mining group) has a market capitalization (16 May) of $218m. Lucara budgets eight diamond sales this year with estimated revenue of $90m (corporate presentation Q1 2013). In addition, the company is completing its first Large Stone Tender in Antwerp with results expected on 22 May. In the quarter-ended March 2013 revenues totaled $32.5m with EBITDA of $14.7m and EPS of $0.02/share. The company closed March with cash of $17.4m.

Karowe Mine completed and producing

While the Mothae project in has been placed on care-and-maintenance following the completion of trail mining in September 2012, Karowe was commissioned in Q2 2012 and has ramped up to full production. Management targets production from Karowe of 2.5m tonnes of ore to produce 400,000 carats in 2013 with operating costs of $23/t. Production in 2012 was 303,000ct.

Exhibit 17; Mill and Crushed Ore Stockpile at Karowe

Source: Company reports

Rising Prices and Large Stone Distribution

Realised diamond prices have increased markedly since Lucara began showing the goods not only in Botswana, but also in Antwerp. The Karowe mine has been producing several large diamonds including a 239ct gem earlier this year, and two blue diamonds that were sold in Q4 2012. The company is concluding its first Large Diamond tender in the offices of Bonas in Antwerp with results due on 22 May. The sale comprises 15 mostly high-colour white diamonds ranging from 11.5ct to 239ct.

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Recent Diamond Company News

Afri-Can Marine Minerals (not rated)

In mid-March, Afri-Can announced an option agreement with Diamond Fields International to acquire a 90% interest in diamond Mining Leases 111, 138, 139 and 32 off the coast of Namibia in the region of Luderitz. Mining Lease 111 hosts an historical resource of 950k ct of gem quality diamonds. The option agreement is valid for two years and in order to complete the acquisition, Afri-Can is required to spend $800k of exploration expenditures on the MLs before the first year anniversary and an additional $2.5m of exploration expenditures before the second year anniversary of the option agreement. Afri-Can entered in the option with its Namibian partner Woduna Mining Holding (PTY) Ltd. Upon exercise of the option on MLs 111, 138 & 139, the interests in the MLs will be: Afri-Can 80%, DFI 10% and Woduna 10%. Upon exercise of the option on ML 32, the interests in the ML will be Afri-Can 90%, Woduna 10%, DFI 7% and Full Screen Investments (PTY) Ltd 3%.

In early May, Afri-Can announced that it had appointed Afrasia Corporate Finance MD Richard Tait to its board; Howard Messias and Michael Nicolai have stepped down.

Alrosa (not rated)

The company announced in early April that the Aikhal underground mine had reached its design capacity of 500ktpa; this run rate is required for the mine to run at its forecast annual diamond production of 2.5mct. It also added further links to China by signing a Letter of Intent with the Shanghai Diamond Exchange, which could see auctions of Alrosa's rough. This follows the signing of a long-term supply agreement with Chow Tai Fook in November. Alrosa also forged links into Africa with its Executive Committee approving the establishment of new joint ventures to engage in prospecting and geologic exploration in African countries; particular focus is on Angola and Botswana.

FY12 financial results were released in late April. The company produced 34.4mct (in line with FY11) and sold 33.2mct (+1% yoy). Revenues of RUB151bn were 10% higher than FY11; EBITDA was down 5% at RUB62bn on account of higher costs. However, Alrosa reported record net profits of RUB34bn. It ended the period with RUB6bn of cash and diamond inventory of RUB27bn. On its earnings call management noted that it expect to see a 10% growth in prices for FY13, with all of that growth in Q1. It expects to see flat prices for the remainder of the year. FY13 sales volumes are expected to increase by 10%. It also gave an update on its proposed IPO, which would see the listing of 14% of its shares currently held privately (7% government held, 7% others). Management expect the IPO to take place in October/November. Following its results, the company has proposed the payment of 32.5% of its profit for dividends (RUB 1.11/sh).

The company's FY12 results presentation can be viewed here.

Botswana Diamonds (not rated)

The company provided an update on its operations in conjunction with the release of its H1/13 results in April. Results from the first year's work with its international partner produced a series of targets in the Orapa region and it has applied for ground covering these targets and awaits the award of licences. The company and its partner have agreed the outline of an operating joint venture on the target areas, which awaits final approval by the board of its partner. At the same time both parties have agreed to extend the original Technical Co-operation Agreement to cover additionally the Gope and Jwaneng areas of Botswana. This lasts until June 30th 2014. The company completed the review of PL170; no kimberlites were identified in drilling. Exploration activities in the Gope area of Botswana continue, while the company has also optioned (for 180 days) two blocks on the Save River

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(which was increased to three blocks in April) in western Mozambique, which it believes could contain alluvial diamonds washed down from Marange. In Cameroon, the company is looking to reach agreement on a joint venture with CNK of Korea, which is developing a new diamond mine. Discussions are slow and cover a wide range of possibilities. The company ended 31 December with £332k in cash.

The company announced in early May that it had extended the three month exclusivity period (previously announced on 5 February) relating to 13 prospecting licenses in the Gope region of Botswana until 14 June.

DiamondCorp (not rated)

In early April, DiamondCorp received its second and final tranche of the $6m term loan from Tiffany. Progress at Lace continued with the commencement of the excavation of a new 66,000 bank cubic metre boxcut, which will provide the surface entrance to the twin conveyor belt and services declines for the life of the mine. Underground blasting commenced during March with a vent raise on the 16. The raise development is continuing on schedule and is expected be completed in Q2. The company completed the rebuild of a 9.5t underground loader, and is progressing upgrades on the DMS. The company has also acquired new equipment and added key operating personnel; it remains on target to commence first production from tailings re-treatment in the next three months.

Following the completion of the Tiffany offtake, Diamondcorp issued 1.5m shares as a success fee. The company reported its FY12 results in early May; it ended December with £4.3m in cash and has received a further £4.2m from Tiffany since its year-end.

The company's updated investor presentation can be viewed here.

Firestone Diamonds (not rated)

The company announced in late March that following a Court Hearing in Maseru, the Judge ruled that Firestone be immediately returned the computer equipment from Liqhobong, which was removed by local police authorities on 16 January. The removal did not impact operations. H1 results were released in late March; the company sold 79kct in the half-year to December for $102/ct, driving revenues of £5.1m; production was 73kct. BK11 remains on care and maintenance at a cost of $45k/mth. The company ended December with £4.2m in cash and £1.9m in inventory.

In early May, the company announced the results of two tenders held in February and March; it sold 56kct for $5.1m, with realized prices of $84/ct in February and $102/ct in April. All parcels tendered were sold and tenders were well attended.

Gem Diamonds

Gem announced the retirement of CFO Kevin Burford in early April; he was replaced by Group Financial Manager Michael Michael, who was subsequently appointed to the board. In early April, we attended a site visit to Gem's Antwerp-based Sales & Marketing and Manufacturing divisions. Link to the RBC Capital Markets note is here.

The company released its Q1 IMS in late April; at Letseng, lower average rough prices of $1,599/ct (Q4 2012 - $1,703) resulted from the mining of a lower-value phase in the Main Pipe. Gem expects to return to the Satellite Pipe by end-Q2, which should result in higher realizations in line with improving market conditions. Waste stripping was slightly down (4%) on Q4 2012 but still high due to work to expose Satellite ore. A 9% fall in mined ore and a significantly lower grade (1.27cpht vs. 1.85cpht) led to 18.8k ct produced – down 38% from Q4. The lower production reflect grade in the Main Pipe, a scrubber breakdown and efforts

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to reduce throughput to investigate breakage. Management reiterated its 2013 guidance of 115-130kct recovered for 2013 despite the low Q1 figures. The plant at Ghaghoo is 90% complete and will await ore from the underground development in Q2 2014. The project is consuming cash as reflected in cash at the centre falling from $53m (end-December) to $45m at end-March. In addition, cash at Letseng halved to $10m, in part a reflection of a dividend paid. Even with planned cost cuts at the centre, Gem is reviewing the rate of development of Ghaghoo in order to conserve cash.

Dominion Diamond Corp

The company has had a busy couple of months; in late March it completed the sale of its Luxury Brand segment from $750m in cash plus the assumption of $250m in pro forma debt, and in early April it completed the acquisition of the Ekati diamond mine from BHP for $500m plus purchase price adjustments of $53m. It also changed its name to Dominion Diamond Corp. Q4/13 results were released in early April; Q4 revenue of $110m was above our $104m forecast and this flowed all the way to the bottom line, with earnings from continued operations of $14.8m against our $11.6m. Down the income statement the line items which deserved mention included SG&A at $10.1m (Q3 - $7.6m) because of increased costs associated with the Ekati transaction ($1.6m) and the sale of the luxury brand ($0.6m), as well as share-based payments. This should reduce in the current quarter.

Q1/CY13 production from Diavik came in at 1.9mct from 0.5mt ore (average grade 3.87ct/t) vs. RBC at 1.5mct. The increase was driven predominantly by an increase in grade vs. our forecast. Diavik production guidance for CY13 was increased to 6.6mct from ~6mct previously. In late April, the company released a Resource Statement for Ekati, which suggests additional life to take the mining operations beyond 2019, with Jay potentially adding significant life if it is proved to be economic. Other areas where value uplift could come would be the value of diamonds sold and cash on hand between end-June 2012 when the Ekati purchase was agreed, and the extent of savings that could come from rationalization of the marketing activities.

The company announced in early May that a new technical report for Ekati is to be published within the coming month, and guided to Ekati production from the acquisition date to end-December of 1mct. It also guided to sales of $730m (RBC $634m), coming equally from its 40% share of Diavik and its 80% stake in Ekati. This includes the assumed sale of $25m of Diavik inventory held at the year-end and $70m of Ekati inventory from the acquisition (which totaled $135m). We would assume that the balance of inventory is held as work in progress. The $70m of inventory is expected to be sold in H2.

The company's updated investor presentation can be viewed here.

Kennady Diamonds (not rated)

The company announced in late March that it had commenced its winter drill program at Kennady North. The first phase of the planned 5,000 meter drill program is focused primarily on infill drilling along the Kelvin – Faraday kimberlite corridor to further define the Hobbes, Kelvin and Faraday kimberlites to a level sufficient to prepare the first resource statement for Kennady North. Newly identified geophysical targets within the corridor will also be drill tested.

Kimberley Diamonds Ltd (not rated)

Kimberley Diamonds (which has recently changed its name from Goodrich Resources Ltd) acquired the Ellendale mine in Australia from Gem Diamonds in December. In early April, the company announced that it had sold 13kct (+11% vs. business plan) in March for $12.6m ($956/ct, +33% vs. the 2012 average grade). Grade of 4.42cpht is an 18% improvement vs.

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the 2012 average grade of 3.74cpht. This marked improvement over historic and forecast results can be attributed to upgrades to the E9 plant along with stronger operational control focused on enhanced recovery, a steady increase in the price of commercial quality diamonds and a noticeable shift to the recovery of larger diamonds, resulting in higher prices achieved driven by the increased focus on the East Pit of the E9 resource in February 2013. In early April, the company completed a $5.6m rights issue, undertaken to fund the acquisition of Ellendale.

In mid-April (while the company was still named Goodrich Resources), the company announced board changes; Goodrich Resources founder Alex Alexander assumed the role of Exec Chairman; Rod Sainty stepped down as MD of Goodrich. Mr Sainty will remain a director of the company and continue to serve in an executive capacity as General Manager – Minerals. Kimberley Diamonds CEO Lee-Anne de Bruin joined the board as MD. Former Ellendale GM Nick Selby joined as Site General Manager and Head of Metallurgy. Finally Gideon Scheepers joined the company as Production Manager in a permanent capacity.

In late April, the March quarterly report was released; highlights included revenue of $30m, EBITDA of $4.6m and net cash flow from operating activities of $6.85m. Guidance for the June quarter is revenue of $26m and EBITDA of $4.5m. The company ended the period with net cash of $13m. The company is currently in a dispute with Blina Minerals over net unpaid debts of $256k.

Lucara Diamonds (not rated)

Lucara released FY12 results in late March. For FY12, the company sold 216kct from Karowe for $54.6m ($253/ct). Total sales forecast for FY13 is 400kct. In FY12 Lucara recovered 303kct vs. guidance of 271kct. Opex for Q4 came in at $92/ct vs. budget of $123/ct. The company sold 4.7kct from Mothae for $1.5m ($324/ct); a February 2013 sale realised $437/ct (on sale of 2kct). The company is reviewing a number of development options for Mothae following the completion of its trial mining program. Cash on hand as at December 31 was $13.3m, including a $4.5m draw down from the company's credit facility. Diamond inventories were $8.4m. In late March, the company appointed Paul Day as COO. Mr. Day is a mining engineer with over 22 years of operations experience in Namibia, Mali, Ghana and South Africa. He has held senior mine and operations management positions with Areva, Anglogold and JCI over his career.

In early May the company released Q1 results; it completed two sales of Karowe goods, totalling 145kct which realised $32.5m. The 2013 sales included six parcels totalling 18kct, which were withheld from the December 2012 sale due to low volumes of competitive bidding. Excluding the December inventory sold in January, the average sales price for full 2013 production sold to date was $243/ct. The company sold its second blue stone (4.77ct), in its March sale for $1.6m or $341,416/ct. The mill treated 0.6 million tonnes during Q1 and produced a total of 123k ct (22.4cpht, which was above expectations). This included six diamonds weighing more than 50ct and 28 diamonds weighing between 20 and 50ct. Opex came in at $86/ct; cash earnings were $16.8m. Cash on hand as at March 31 was $17.4m, and inventories totalled $5.8m.

The company is currently holding its first Large and Exceptional Stone tender which will close on May 22. The tender will feature 15 single diamond lots from the Karowe Mine in Botswana, including the recently recovered 239 ct diamond. Viewings commenced in Gaborone, Botswana on April 26 and moved to Antwerp on May 3.

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Merlin Diamonds Ltd (not rated)

The company continues to be the subject of a takeover bid by Innopac Holdings. The directors of Merlin currently recommend that the offer is accepted by its shareholders.

Mountain Province

The company provided an update on the Gahcho Kué project in early April. Following completion of a ground gravity survey, ten targets for the first phase of the exploration drill program were identified and drilling should have been completed by the end of April. Based on the success of the first phase drill program, consideration will be given to testing additional targets that have been identified. Planned deliveries of materials, equipment and fuel to the GK site were completed on schedule by the end of March. An updated NI 43-101 for the Tuzo kimberlite is expected to be completed by the end of Q2. At 31 December, the company held $274k in cash.

Namakwa Diamonds (not rated)

The company's shares ceased trading on AIM on 25 March.

North Arrow Minerals (not rated)

North Arrow acquired an 80% interest in each of the Qilalugaq, Pikoo and Timiskaming exploration projects from former Stornoway director Eira Thomas in March. The projects were acquired by Ms. Thomas from Stornoway; North Arrow will have options to earn an 80% interest in each of the projects upon completion of a defined exploration program specific to each project. Stornoway retains a one-time back-in right to re-acquire a 20% interest in each project, thereby increasing its interest to 40%, by paying the optionee an amount equal to three times the cost incurred by the optionee in connection with the project-specific option work program. In April, the company closed a $3m non-brokered private placement.

In May, the company filed a NI 43-101 restating and confirming the Mineral Resource estimate for the Q1-4 kimberlite located at the Qilalugaq. This is unchanged from the June 2012 estimate published by Stornoway. Highlights include a total Inferred Mineral Resource for the Q1-4 kimberlite pipe of 26.1m ct with an average +1 DTC total diamond content of 53.6cpht extending from surface to a depth of 205m and an additional resource upside of 7.9 - 9.3m ct with an average +1 DTC total diamond content of 56.1cpht, extending from 205m depth to 305m depth. Also in May, the company announced that initial drilling program at Timiskaming did not intersect kimberlite; drilling consisted of five drill holes (547 m) testing four targets located up ice from an unsourced kimberlite indicator mineral train. The company's requirements for an earn-in on Timiskaming are now complete.

Olivut Resources (not rated)

In March, Olivut announced that it had entered into a Securities Purchase Agreement to raise up to $18m over the next 36 months in a tranched placement of securities to the Canadian Special Opportunity Fund, L.P., a fund managed by The Lind Partners. This process continues. On April 8, the company announced that it had closed its previously announced private placement of a $300,000 callable, convertible security. In May, the Canadian Special Opportunity Fund was issued 712,504 shares of the company as repayment for the initial $200,000 tranche funding received on March 13 and rolled over to April 12. Also in accordance with the terms of the agreement, CSOF has advanced to the company $68,372 for the next tranche financing for which it is anticipated shares will be issued on June 10. The terms of the agreement permit the company to take into account current market conditions to avoid excessive dilution.

AGM presentation here.

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Pangolin Diamonds Corp (not rated)

The company raised $1.6m through a non-brokered private placement in early April, which was higher than the initial placement amount of $1.26m. In early May, the company announced that it had discovered its first kimberlite at its 100% owned Tsabong North Project in Botswana. Core logging identified crater facies sediments and underlying reworked volcaniclastic kimberlite ("RVK") breccias in drill hole "Magi-01/1". Crater facies sediments are present from a depth of 33.5 meters to 58.8 meters below which RVK breccia occurs to 76.3 meters. The crater facies sediments and RVK breccias intersected are consistent with the equivalent lithological units observed in the core of drill hole M1/50 from the M1 Kimberlite in the Tsabong Kimberlite Field, which was drilled in 1981.

Peregrine Diamonds (not rated)

The company announced in April that it had collected a 508 wet tonne bulk sample by surface trenching from the CH-6 kimberlite. To date, approximately 325 tonnes of the 508 tonne bulk sample from the CH-6 kimberlite have been transported to Iqaluit where the sample is being stored until the summer when it will be transported to Montreal on the sealift. The sample is currently scheduled to be processed by the Saskatchewan Research Council in Saskatoon in the fourth quarter, followed by independent valuations of the resulting diamond parcel. Peregrine will not commence processing of the bulk sample until the earlier of: 1) De Beers delivering to the company binding notice of their decision regarding their right to enter into an earn-in and joint venture agreement for Chidliak, or 2) the expiry of this right. Peregrine's objective is to utilize the diamond grade and value information from the bulk sample and geologic and diamond content information acquired from core drill programs conducted in 2009, 2010 and 2011 to develop a preliminary revenue model and establish an initial resource for CH-6. This work will serve as a foundation for future independent resource calculations and together with the mining study being completed by De Beers, enable the completion of a Preliminary Economic Assessment for CH-6 in the first half of 2014. As reported on December 6, 2010, a 14.11 tonne mini-bulk sample collected from CH-6 returned a grade of 2.84 ct per tonne. If that grade is confirmed with further testing, CH-6 would be one of the highest grade kimberlite pipes in the world.

The company's updated investor presentation can be viewed here.

Petra Diamonds

In mid-April the company announced that it had recovered a rare 25.5ct blue diamond from Cullinan. Photos of the stone can be seen here.

In early May the company released its Q3 IMS; production of 647kct was up 4% yoy and up 9% qoq, driven by stronger production at Williamson (commissioning of rebuilt treatment plant) and Kimberley (ramp up of plant throughput and stronger grades). Finsch production was flat yoy (a mixture of weak ROM production due to underground maintenance and strong tailings production driven by stronger throughput and grade), while Cullinan production was down 7% predominantly due to weaker grades. Petra sold 668kct in Q3, up 7% vs. Q3/12, for $106m, up vs. $98m in Q3/12. Average prices were slightly up yoy at $158/ct, vs. $156/ct previously. Prices were broadly up across the board vs. guidance (except Koffie) and on a qoq basis (except Williamson), with the largest price rises at Finsch (+11% qoq) and Kimberley (+16% qoq). Williamson prices were down 4% qoq. While prices remain below year ago levels, the rough market uptrend since last November seems intact and the outlook is positive for the remainder of the financial year.

Petra did not receive acceptable offers for its held for-sale Fissure mines. Petra intends downscaling Sedibeng and Star and operating Helam on a normal commercial basis. The company will continue to consider any further offers should they arise. PDL ended the period with $35m in cash and $40m of rough diamonds in inventory. Headroom available at 31 March was $111m.

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Rockwell Diamonds (not rated)

The company announced in mid-April that it had reached an agreement to sell the non-core Klipdam mine and associated properties for a total cash consideration R23 million, bringing total sale proceeds from Klipdam to R48m. The proceeds will be reinvested in bringing the Niewejaarskraal Mine into production and progressing its strategy of growing its operating footprint in the Middle Orange River region of South Africa.

In early May, Rockwell released an operational update, which was in line with plan. On a consolidated basis fourth quarter gravel volumes processed declined by 6% to 619,546m³ year on year with a commensurate change in diamond production of 3,854 ct (vs. 4,043ct in Q4/12). The reduction in volume is largely the result of placing the Tirisano Mine on care and maintenance in December 2012, and consequently if Tirisano was excluded, the remaining operations showed a 9% improvement, both in gravel volume processed and diamonds produced for the same period. The Saxendrift operations (comprising Saxendrift, Saxendrift Extension and the Bulk X-ray plant) delivered a 36% increase in ct production although gravel volume processed declined by 5%. Klipdam achieved a 44% increase in gravel processed, demonstrating the benefits of outsourcing the mining operations. However, Klipdam's ct recovery declined by 45%, underscoring management's decision to sell the mine. The company also announced that it had sold 5.3kct in Q4/13, vs. 5.8kct in Q4/12, for $7.2m ($1,355/ct), vs. $6m ($1,041/ct) previously.

The company announced in mid-May that it had updated a PEA on its Wouterspan alluvial diamond property. The study indicated positive economics, sufficient to take the project to the detailed design stage. The economic model yielded an internal rate of return of between 45% and 70% for a range of scenarios based on the key inputs. The NPV for the base case is $91.7m at a 15% discount rate, yielding a project payback period of 2.3 years from the start of construction or approximately 1.3 years from commencement of production. The project is most sensitive to revenue with a 5% variance in the total revenue over the 10 year life of mine, impacting the NPV by 15%. The operation is expected to employ 300 people. The PEA assumes a $42m capex cost, with a mining rate of 1,200tph, grade of 0.622ct/100m³, average ct value of $2,300/ct and contract mining unit cost of $8.88m³.

Shore Gold (not rated)

The company released FY12 results in late March; it ended December with cash of $1.7m, short-term investments of $7m and restricted cash of $1.8m. It also announced at the same time that it had appointed current Controller Greg Shyluk as interim CFO. Mr. Shyluk has been with the company since January 2007. In early April, the company announced that responses have been prepared and submitted for the 56 comments and information requests on the revised EIS for the Star - Orion South Diamond Project that were received from the Canadian Environmental Assessment Agency.

Shore Gold released its Q1/13 results in early May; the company ended the period with $1m in cash, $6m in short term investments and $1.8m in restricted cash. During the quarter, the company’s main focus was working on the preparation of the final EIS for the Star – Orion South Diamond Project and continuing to seek opportunities for development capital for the project.

The company’s updated investor presentation can be viewed here.

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RBC Capital Markets

Stellar Diamonds (not rated)

We have seen limited newsflow from Stellar since our last diamond report. The company released its H1/13 results in mid-March; it ended the year with $205k in cash. In his management commentary, CEO Karl Smithson noted that the first half of 2013 will be dedicated to completion of the conceptual economic scoping studies to better define the project economics at Tongo and Droujba. Independent contractors Paradigm Project Management have been appointed to conduct these studies, which are well under way and on track to be delivered within the designated time frame. A decision will then be made on whether to advance Tongo and Droujba to the pre-feasibility stage in the second half of 2013.

Stornoway Diamond Corporation

The company announced in late March that due to favourable weather conditions, construction of the Renard Mine Road had commenced earlier than anticipated, with overall progress already standing at 12% of expected work. First all-season vehicle access to Renard is currently scheduled for the fourth quarter of this year, as previously anticipated. In early April, the company announced the results of an independent valuation on the Renard 65 bulk sample diamonds, which resulted in: an average price of $250/ct on the total Renard 65 parcel of 997 ct; a diamond price model for Renard 65 of $180/ct with a "High" sensitivity of $203/ct and a "Minimum" sensitivity of $169/ct; and valuations of $8,500/ct and $5,900/ct on the two largest stones of 9.77ct (G colour) and 6.40ct (F colour), respectively.

Trans Hex (not rated)

We have seen little newsflow from Trans Hex since it released interim results for H1/13 in late October.

Companies Mentioned that are covered by RBC Capital Markets Research:

Anglo American Plc. (LSE: AAL; £185.55, Underperform)

BHP Billiton Plc. (LSE: BLT; £19.16, Outperform)

Gem Diamonds Ltd. (LSE: GEMD; £1.31, Sector Perform)

Dominion Diamond Corp Inc. (NYSE: DDC; $15.12, Outperform)

Mountain Province Diamonds Inc. (TSX: MPV; C$4.97, Outperform, Speculative Risk)

Petra Diamonds Plc. (LSE: PDL; £1.04, Outperform)

Rio Tinto Plc. (LSE: RIO; £328,73, Outperform)

Stornoway Diamond Corp. (TSX: SWY; C$0.60, Outperform, Speculative Risk)

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