

DIAMOND FINANCE

the financial & accounting newsletter for the diamond industry

Conference Special

October 2007

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Jeremy writes

After the conference was over, I congratulated, the Antwerp World Diamond Centre's CEO, **Freddy Hanard**, on an excellent job of organising the conference. He explained that he had achieved the aim of making the discussions controversial and was glad that there had been genuine debate.

We all enjoyed hearing the **South African Minister for Minerals and Energy** asking the president of Alrosa, Sergey Vybornov, if he would be willing to send rough from Russia to be manufactured in South Africa! Oddly enough, some rough already is. Rough diamonds delivered to sightholders in Africa are often mixed with goods from other countries like Russia.

Mr Vybornov was succinct about beneficiation's chances of failure, reminding us how little polishing is still happening in Russia. He summed it up dryly, noting, "You don't locate a uranium processing plant next to a uranium deposit."

With regards Antwerp's future as a diamond centre, more people should have listened to what **Sir David Brewer**, former Lord Mayor of London, had to say. In his opinion, you need not be concerned that beneficiation might draw some of the gravity of the diamond trade to Africa. As long as you are adding value and being creative you can hold your own.

Drawing on the experience of the City of London as the leading financial, equity and insurance market in the world, he cited various examples of other centres trying to take the lead, and ending back in London. When the Euro was introduced and the UK opted not to join, Frankfurt was poised to supersede London as the main Forex centre. Today, Deutsche Bank's main foreign exchange section is in London. The competition has been good for London, and speakers at the launch event of Dubai's IDL certificates hoped competition would keep Antwerp, too, competitive and creative.

Certain speakers were doubtful if beneficiation could work without subsidies or market intervention. Currently, there is a hidden subsidy, as the better and larger stones are retained for local manufacturing while the lower qualities and sizes go to London to be distributed from there to other manufacturing centres.

Gareth Penny, managing director of the De Beers group, stressed his eight point master-plan for beneficiation, but could have added a ninth point; that his group is pushing much of the burden of beneficiation onto their sightholders. This strategy, it seems, has worked so well with the Kimberley Process and SOC generated marketing that it can surely also work with beneficiation.

Professor Stiglitz, head of the world bank, observed that without the financial benefits of beneficiation being reinvested in advancing the diamond industry, the macroeconomic benefits will be short term.

Kennedy Hamutenya, the diamond commissioner of

Namibia, showed an interesting presentation of the development of the diamond industry in his country over the last 85 years, including a few slides of the first rough diamond discovered there. A black railroad worker found the stone, and he achieved fame. His foreman sold the stone, and he achieved wealth.

He was very forthright about some of the difficulties of doing business in his country. He commented that the trade unions, used to fighting apartheid, are very powerful, now fighting different bosses!

President Johnson Sirleaf of Liberia described her country's achievements to date and the difficult challenges it faces to reap the economic benefits that diamonds can bring, while still building up the legal and administrative infrastructure. It is amazing how one person can change a country.

Bob Geldoff highlighted the hypocrisy of the diamond industry's commitment to Africa. He was wrong for a few reasons. The moral debt to Africa has to be paid by the whole developed world, not just a handful of diamantaires, although the mining companies of all mineral products, not just diamonds, should be at the forefront. A lot of sightholders donate large sums of money and amounts of time to charitable causes around the world. If it is not already, Africa should also be on their list, but Africa cannot be the exclusive recipient of the diamond sector's benevolence.

However, I believe that Sir Geldoff missed an opportunity. Having succeeded in arousing the audience, if he had called out for 40 people to come up and each pledge \$50k to help Liberia's KP development, he might have collected, big time. The gala dinner could then have ended with President Johnson Sirleaf going home with a much needed check from Bob for \$2m instead of a diamond brooch which the president is not allowed to



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wear, featuring Liberia's flag.

One of the most telling comments came from **Varda Shine**, who asked, "why is the price of diamond jewellery going down while the price of ladies handbags going up?" This is an issue worthy of a conference on its own. Undoubtedly, if we can make diamond manufacturing more profitable, then beneficiation has a stronger chance of succeeding.

Overall, I left the conference slightly disappointed, I had hoped to hear more about initiatives to make the move to Africa work. There is going to have to be more cooperation between the producing countries, and the smaller producers need extra help.

If consumers around the world are happy and willing to pay extra for fair-trade and ethical products, the producing countries should create an African beneficiation brand where the premium charged goes to education in Africa. Instead of wannabe African sightholders proposing small-scale brands, the sightholders, the DTC, the other African mining companies and the governments involved could combine their efforts to brand the African beneficiation diamond to create wealth and opportunity for Africa.

Customers will pay for this and maybe then beneficiation will truly work for everybody. ■

For the benefit of readers who are unfamiliar with 'beneficiation' I include below an article that first appeared on www.diamond-portal.net and which is a first in a series of articles I am writing on the subject.

Beneficiation

[Origin: 1870-75, Americanism; < Sp benefici(ar) to benefit, profit from (especially mining or farming) (v. deriv. of beneficio < L beneficium;

From Canada to Africa, governments are forcing the DTC to sell rough diamonds locally to manufacturers who are obligated, through a system of beneficiation, to polish them in factories which employ their populace. The philosophy is that between the mine and the ring, a lot of value is added to each stone. When the rough is sold directly from the mine and polished elsewhere, the added value leaves the country never to return. If diamond manufacturers are forced to polish some or all of their stones in the country of the mine then some of that added value will stay in the producing country. And, by employing thousands of locals in semi-skilled positions their governments hope that their economies will benefit from the extra revenue and that the corollary will be skilled positions as artisans and professionals.

The Issues:

The concept of beneficiation is laudable, but history has shown that beneficiation is not so straightforwardly successful. The best example is Russia which used to sell its rough at a discount if it was manufactured locally. This worked for a few years, and rough customers were willing to forgo the low efficiency of the Russian factories as they were →

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more than compensated by the price discount; however, once the discount was reduced, the polishing industry started to disappear. Fortunately for Russia, increasing oil and gas revenues picked up slack in the economy.

How to be Successful:

Many diamantaires have tried to manufacture diamonds in countries around the world where labour was cheap or where governments offered subsidies to create jobs. But these projects were frequently not economically viable, either because the local workforce was not suited to diamond polishing or because the government assistance was subsequently removed.

In order for beneficiation to succeed, a clear long term strategy is required to help the local diamond polishing industry. But a lot of effort is required by the producing governments to make sure beneficiation starts smoothly.

- Administration has to be smooth, helpful, professional and non-intrusive;
- Fiscal policies have to be designed which attract other aspects of the pipeline to be added to the polishing activities;
- A whole range of physical infrastructural aspects have to be addressed including transport, security, hotels and facilities surrounding the factories;
- Access to local skilled professionals;
- Provisions of locals prepared for working in diamond factories;

More than this, though, governments must understand that diamantaires are businessmen who excel at buying rough, polishing the stones and selling then on down the pipeline – and making a profit. Governments have to work hard to ensure that at sooner rather than later, their beneficiation policies also create profit for the diamantaires.

The next few articles will look at a variety of infrastructural, commercial, legal and fiscal issues have to be addressed for the longer term success off beneficiation. We shall also address what the long term aims should be.



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Various speakers at the diamond conference spoke about the risks of beneficiation. The most forthright was Sergey Vybornov, the president of Alrosa commented on the failure of beneficiation in Russia as a long term strategy. When Alrosa reduced the premium granted on rough for local production the industry rapidly declined.

But the way everybody was speaking, one would believe that beneficiation was the answer to all of Africa's problems. The idea is brilliant and the logic is simple; the total price of the rough at the mines is \$13.1bn while the consumers are paying a total of \$68.5bn, so let's make sure some of that \$55.4bn stays in Africa.

Diamond manufacturers are desperate for rough so it is easy to force them to comply with beneficiation requirements making everybody, in theory, happy. Governments create lots of jobs, manufacturers receive their rough, workers have jobs with healthcare etc. and even the DTC is managing to stay in the picture.

The problem is that beneficiation is a tax on diamond manufacturing which is probably the least profitable stage in the pipeline. Beneficiation creates inefficiencies in manufacturing which go directly against the DTC's strategy of making the diamond pipeline more efficient. This is a tax which cannot be recouped from increased revenues down the pipeline.

The conference touched on the moral obligation of Antwerp's diamantaires to invest in Africa. Diamond manufacturers and dealers have no moral obligation to invest in Africa any more than Antwerp's BMW dealers have to invest in Germany. But just as BMW's dealers and customer want to know that BMW maintains high social and ethical standards across its factories, the diamond industry has to expect the same from its mining suppliers. The moral obligation rests with the mining companies and it is illogical to tax the diamond manufacturers for the obligation of the mining companies.

And if the aim is to benefit Africa and Africans, is beneficiation the best value for money?

If the vision is to create sustainable diamond industries in these countries then very clever government policies and regulations will be required to restrain the economic urge of the African sightholders to move the rough to India and China where polishing is far more efficient. Alternatively, granting the African sightholders the better and larger goods while leaving the cheaper goods for other

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polishing centres is a hidden subsidy which a few speakers spoke strongly against.

Can Botswana create a major diamond exchange in Gaborone and push out other contenders like Dubai? Does the world need anymore diamond exchanges?

What will happen if in three years' time half of the sightholders do not reapply because they are fed up with losing money every year? Beneficiation could be left with thousands of semi-skilled workers who cannot do anything else, disillusioned sightholders with hefty losses and embarrassed politicians. Beneficiation rarely works as a long term standalone strategy.

From a macroeconomic perspective, perhaps it would be better to just tax the rough. Let the DTC replace its VAS and give that money instead to the producing countries, with the funds earmarked for education, healthcare, tourism and micro-financing loans which the World Bank has been so successful with in a variety of countries.

For example, Botswana produces \$3.4bn of rough. And the total VAS the DTC charges on it is about \$60m. Under beneficiation, approximately 6,000 jobs will be created at an average pay of \$3,500 p.a. a total of \$21m. Add on a further \$9m

for other annual economic benefits of beneficiation and you are still at 50% of the VAS. On the other hand, \$60m would go a very long way in a country like Botswana.

Scrap the VAS and give it back to Africa for healthcare and education. These have been proven to give the greatest economic return to both developing and advanced economies. Leave the manufacturers to manufacturer wherever they want and keep that pipeline as efficient as possible so that demand for diamond jewellery will continue to rise.

And if it is economically viable to manufacture in Africa, let the market so decide. ■

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