BOTSWANA
DIAMONDS PLC

21 January 2013

DIAMOND MARKET REPORT – H2 2012

INDUSTRY STRUCTURE

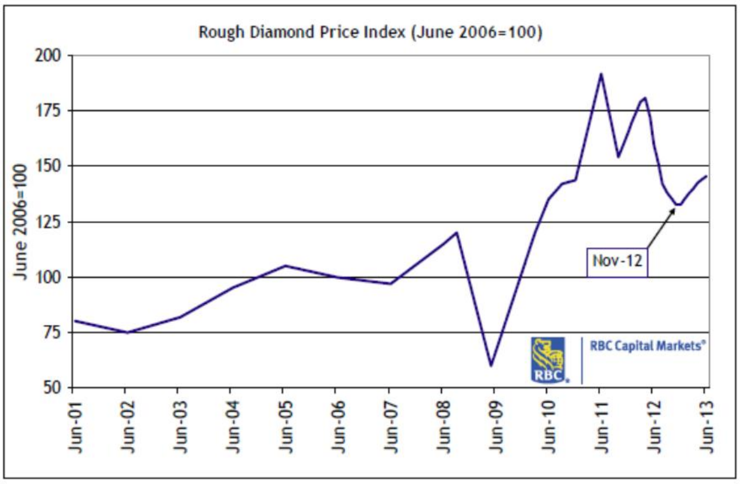
2012 was been a year of significant structural change for the diamond industry.

- The Oppenheimer family completed the sale of their 40% share of De Beers to Anglo American, ending a legacy of four generations of family ownership of the world's most prominent diamond company
- Anglo American cemented its ownership of De Beers at an 85% share, whilst leadership changes at the top of Anglo American have been announced
- Alrosa reinforced its position as global leader in production terms, expecting to produce 7mcts more than De Beers in 2012, and achieve $4.5bn of of sales in 2012 ($3.9bn in 2011)
- De Beers' sales and marketing division, DTC, continued its move from London to Gaborone, Botswana, as local beneficiation gathered further pace
- Okavango Diamond Trading, the independent, stated-owned marketing arm in Botswana began preparing for its auctions of 10-15% of Debswana production
- The Marange deposit in Chiadzwa, Zimbabwe, produced an estimated 12mcts of rough in 2012
- BHP-Billiton agreed to sell its Ekati mine to Harry Winston for $500m and Rio Tinto attempted to sell its diamond division, together accounting for 15% of global rough diamond supply
- Gem Diamonds sold its Ellendale mine in Australia to Goodrich Resources
- Strategic upstream investments by downstream players, such as Tiffany, have increased as long-term supply concerns drive new approaches to mine development financing

DIAMOND MARKET - 2012

Against this backdrop the global diamond market continued to operate during the 2nd half of 2012 in precarious fashion. Although diamond prices remained, in relative terms, at historically high levels, 2012 was without doubt a difficult trading period for diamond players.

Unlike in 2011, when prices rose dramatically by up to 50% between January and August, followed by a sharp drop in September, the prices of rough diamonds have struggled throughout 2012.



Source: RBC Capital Markets

The diamond market was unable to repeat 2011's strong early performance due to a combination of leading factors:

- declining marginal demand coming from the key emerging consumer markets of China and India
- the impact of the weak US economy and the financial crisis in the Euro zone
- the devaluation of the Indian rupee
- the pricing policy of the main producers, DTC and Alrosa, remaining firm despite tightening liquidity and margins for their clients

As we reached the middle of 2012, the trade struggled to retain profitability; clients began rejecting their rough diamond allocations (a sure sign of a lack of trading or manufacturing profitability), prices achieved in tender sales were beginning to slide and eventually something had to give.

Both De Beers and Alrosa dropped prices by a few per cent (low single digits) in June; but this was not considered enough by the market, as it did not provide any "oxygen" to the market. In July De Beers took the rare step of allowing its customers to defer up to 50% of their allocations until up to March 2013 whilst further reducing prices by 2-3%. Alrosa held its prices but allowed its clients to defer up to 30% of their July purchases. Clearly both main producers did not want to lower prices too much and attempted to use the volume lever to calm the market. However by the end of August both producers were obliged to drop prices by a further 8-10% and lower the physical volumes they put into the market. Since September, prices have remained relative stable; De Beers even put out a message that it was not going to reduce prices further and that production shortfalls in H2 2012 would become apparent later in the year. However a large DTC October sale of an estimated $700-750m further choked a trade struggling to recover.

The medium–sized producers, such as Gem Diamonds and Petra Diamonds, reported revenue/rough price decreases, but these were in line with the overall market.

It was not all doom and gloom though – diamonds were being sold continuously into the trade, some juniors such as Namakwa Diamonds were performing well with their tender sales; BHP and Lucara's prices also recovered in H2.

Alrosa also took advantage in H2 of its ability to sell rough to the Gohkran in Russia (reportedly $230m in 2012) and maintain sales levels whilst not putting undue pressure on the international markets.

A key difference between previous times and the current diamond market is that De Beers no longer dominates the rough market and therefore no longer has the ability to control global supply pricing. Importantly Alrosa plans to increase its production to 40m cts p.a. within 5 -7 years. There are now several important players in the market and this new competitive dynamic with differing distribution models creates an intrinsically more volatile trading environment.

As we ended 2012, rough diamond prices had fallen -18 to -25% year-on-year, depending on which diamond producer one considers. Prices stabilised in Q4 and the year ended on a reasonably positive note, after an admittedly tough year.

The banks, who finance the trade, continue to monitor carefully the levels of trade debt and their clients' financial health. All eyes are on how the US Thanksgiving and Christmas seasons performed, rapidly followed by Chinese New Year in February 2013.
Polished prices edged both upwards and downwards over 2012, but resulted in an overall negative performance; polished prices were estimated to have ended 2012 at -11% year-on-year, averaging -4% for the whole of 2012 (source: PolishedPrices.com).

The important trade fairs of Hong Kong and JCK (Las Vegas) highlighted the weakness in the wholesale market as polished buyers attempted to pull polished prices down with limited success. This was in stark comparison to firm major producer prices for the rough diamonds.

As the year drew to a close, the polished trade was still battling with buyers seeking to negotiate prices downwards, a general reluctance to buy polished for stock and hold inventory and short-term uncertainty regarding levels of consumer demand.

However there is strong hope that the key US market has performed well over the holiday season, despite the recent hurricane, and that the new leadership in China will boost both consumer confidence and domestic consumption.

DIAMOND MARKET - GOING FORWARD

There are mixed views amongst industry commentators regarding 2013 price growth; but all views are robust and positive for the longer term.

Botswana Diamonds expects there to be more positive sentiment in the rough diamond market in early 2013 followed by a relatively steady price performance for the rest of the year, with a further lift before the key season in H2. This is predicated on relatively stable distribution behaviour by the two key producers, De Beers (no.1 by value) and Alrosa (no.1 by volume).

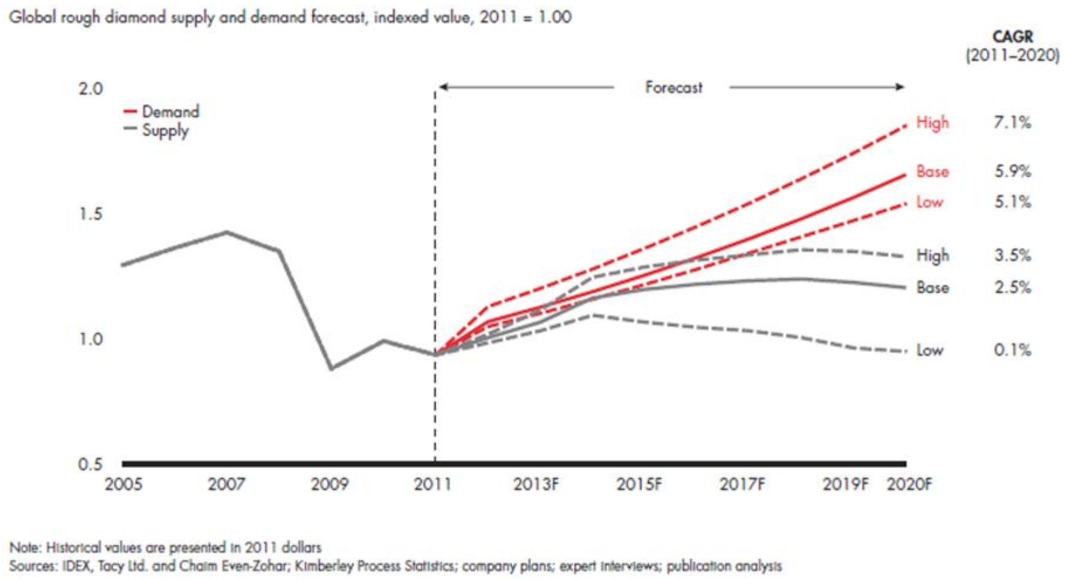
The key drivers here are the reduced volume of rough available from De Beers in the short-term, as their maintenance, waste-stripping and safety improvement programmes conclude (production at 27mcts in 2012) and a stabilising global economy.

Longer-term, the fundamentals of the diamond market remain healthily robust. The price trend is certainly expected to be upwards driven by limited supply going forward, few new mines coming on-stream and continued growing demand from the emerging markets.

The report published by Bain & Co in December 2012 estimated that rough diamond demand would increase by 6% per annum until 2020, doubling the size of the industry. 2012 has not played out this way, but the anticipated price growth will come as the global economy recovers.

Global rough production for 2011 was estimated at 124mcts (value $14bn); in 2012 around 130mcts; and this figure is predicted to remain relatively stable in the coming years, potentially growing to 157mcts by 2020.

Merrill Lynch recently stated its positive view on the long-term fundamentals of the industry, citing diamonds as a "secular, late development commodity" with significant growth potential due to the low per capita consumption at present in the emerging markets and the expected supply-demand deficit in the medium-long term. The supply demand imbalance will offer opportunities for juniors both in re-evaluating existing ground and new blue sky territory.



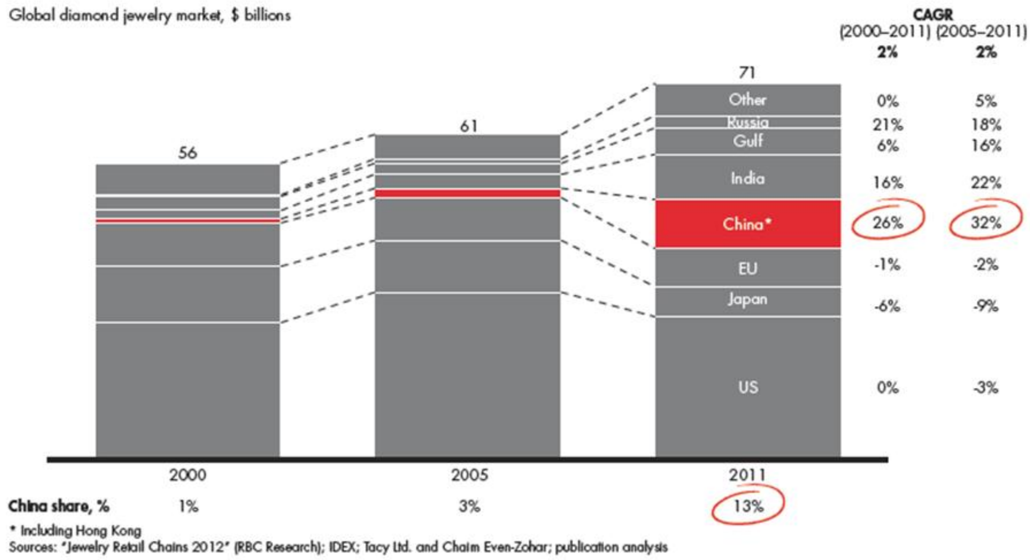
Source: Bain & Co

DIAMOND JEWELLERY DEMAND – KEY MARKETS

The US remains the world's biggest consumer market for diamond jewellery at around 40% of global sales by value. Japan remains resiliently at around 8% despite last March's environmental catastrophe.

The emerging markets, led by China and India, continue to grow strongly, despite a slowdown in the levels of growth in 2012. Bain estimates Chinese diamond jewellery demand to have grown between 2005 and 2011 at 32% CAGR; and India at 22% CAGR. Chinese consumption for diamond is still predicted to have grown by 10% in 2012, and India at a similar level. Indeed these two markets combined are anticipated to exceed the size of the US market by 2020.

The predicted surge in global demand for diamond jewellery will struggle to be matched by the supply of diamonds.



Source: Bain & Co

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