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This section contains certain information which is derived in part from various official government publications, industry sources including industry publications, and from surveys or studies conducted by independent third-party sources such as the Altagamma Foundation and Bain & Company. We believe that the sources of such information are appropriate sources for such information, and we have taken reasonable care in compiling, extracting and reproducing such information. We have no reason to believe that such information is false or misleading, or that any material fact has been omitted that would render such information false or misleading. Such information has not been independently verified by us, our affiliates or advisors and no representation is given as to its accuracy. None of the information in this Industry Overview section is based on or otherwise derived from reports or sources commissioned by us, our affiliates or advisors. Unless otherwise indicated, all historical and forecast statistical information with respect to the Global Luxury Goods Industry Overview section, including trends, sales, market shares and growth levels, is from the Bain Luxury Study — Altagamma Worldwide Market Monitor*, a report published together by the Altagamma Foundation and Bain & Company. Sales figures are tracked and reported in Euros in this study. In addition, unless otherwise indicated, all sales data set forth in the Global Luxury Goods Industry Overview section refer to retail sales and all forecasts beyond 2011E are at constant 2011E exchange rates. Luxury goods industry segments and product categories refer to the definitions used by the Bain Luxury Study — Altagamma Worldwide Market Monitor. Unless otherwise indicated, all historical and forecast statistical information in this section, including trends, sales, market shares and growth levels, is from the Bain Global Diamond Industry Report published in December 2011.

Introduction

We are a leading vertically integrated diamond jewellery company. Our operations comprise the design, manufacture and retail distribution of high and ultra high end jewellery and watches, and the sourcing, cutting and polishing of rough diamonds primarily for use in our retail operations.

Global Luxury Goods Industry Overview

We sell our products in the global luxury goods market. The global luxury goods market can be subdivided by luxury segment, product category, and geography. We are positioned in the absolute luxury segment. We offer hard luxury products. We sell our products globally.

The Global Luxury Goods Market

Total sales in the global luxury goods industry were a record €191 billion in 2011E. The industry has grown since the turn of the millennium, with industry sales having increased from €133 billion in 2001 to €191 billion in 2011E, representing an approximately 4% CAGR. During this period, the industry has proved resilient despite a variety of economic crises. From 2001 to 2004, the global luxury goods market grew by approximately 2% despite the economic impact of the September 11, 2001 terrorist attacks in the United States, the SARS outbreak in 2003 and the depreciation of the United States dollar relative to the Euro. Similar resilience was seen during the global financial crisis of 2008 and 2009. Despite the world’s major economies being severely affected by the financial crisis, the market grew by approximately 2% from 2007 to 2010. The industry has not only proved resilient, but also capable of rapid recovery as evidenced by the 6% growth in 2004 and the 13% and 10% growth in 2010 and 2011E, respectively. The evolution of the global luxury goods market from 1995 to 2011E is set forth in the following graph.

* Altagamma Worldwide Markets Monitor is a publication prepared by the Altagamma Foundation, together with Bain & Company, that periodically analyses the global consumption of high-end products. The Altagamma Foundation was founded in 1992, and in 1999 set up the Altagamma Worldwide Markets Monitor, an annual research report, whose conclusions are based on an analysis of the financial statements of 200 global high-end brands and of approximately 500 companies that manage the businesses of those brands. The Altagamma Worldwide Markets Monitor is presented during the Altagamma Observatory in October of each year. A semi-annual update of the Altagamma Worldwide Markets Monitor is also presented in April or May of each year. Bain & Company, which was founded in 1973, is a global business consulting firm with 44 offices in 29 countries. Bain & Company has worked with over 4,400 major multinational, private equity and other corporations across every economic sector.
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Exhibit 1: Global luxury goods market: 1995 to 2011E

Source: Bain Luxury Study — Altagamma Worldwide Market Monitor (October 2011)

The Absolute Luxury Segment

The global luxury goods industry can be divided into three segments according to Bain Luxury Study — Altagamma Worldwide Market Monitor: accessible, aspirational and absolute. Brands in the absolute luxury segment are characterised, more than others, by exclusive distribution, a storied heritage, highest quality product offering and highest price points in their respective categories. Brands in the absolute luxury segment generated sales of approximately €40 billion in 2011E.

Exhibit 2: Three segments of the personal luxury goods market

Source: Bain Luxury Study — Altagamma Worldwide Market Monitor

The absolute luxury segment primarily caters to high and ultra high net worth individuals, whose wealth has historically proven to be less affected by economic volatility. The pool of high and ultra high net worth individuals’ wealth has grown since 2008. High net worth individuals’ wealth grew 18.9% in 2009 and 9.7% in 2010 to reach a record US$42.7 trillion, which surpassed the previous peak in 2007 (source: Capgemini
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The absolute luxury segment has been a main beneficiary of high and ultra high net worth individuals’ growth in wealth. From 2005 to 2010, the absolute luxury segment grew at an approximate 6% CAGR compared to the overall global luxury goods market that grew at an approximate 3% CAGR. This trend continued in 2011E with absolute luxury growing 12–14% compared to 10% growth in the overall global luxury goods market. The absolute luxury segment has also proven less susceptible to economic crises, growing at an approximate 2% CAGR from 2007 to 2010, higher than the approximately 1% CAGR of the overall global luxury goods market.

The absolute luxury segment is forecast to grow from approximately €40 billion in 2011E to approximately €51 billion in 2014F, representing an 8% to 10% CAGR between 2011E and 2014F. The following graph illustrates the historical evolution, as well as the forecast development, of the absolute luxury segment between 2005 and 2014F.

Exhibit 3: Absolute luxury segment: 2005 to 2014F

Note: 2012F–2014F figures are at constant 2011E exchange rates
Source: Bain Luxury Study — Altagamma Worldwide Market Monitor, Spring Update (April 2012)
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Hard Luxury
The global luxury goods market can be split into the product categories shown below.

**Exhibit 4: Global luxury goods market product categories: 2005 to 2014F**

The hard luxury category covers luxury jewellery, watches, pens, and lighters. The hard luxury category generated sales of approximately €40 billion in 2011E, representing 21% of the global luxury goods market, with jewellery and watches accounting for nearly all category sales in 2011E. Due to strong growth in both jewellery and watches, the hard luxury category grew faster than all other categories in both 2010 and 2011E. Hard luxury is expected to reach an approximately 23% share of the overall global luxury goods market in 2014F, up from 21% in 2011E as result of above average growth compared to the overall luxury goods market.

**Exhibit 5: Luxury jewellery and watches market development: 2009 to 2011E**

Source: Bain Luxury Study — Altagamma Worldwide Market Monitor (October 2011)
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Exhibit 6: HNWI allocations to “investments of passion” 2010 (%)

By its nature, hard luxury has a relatively smaller fashion content than most other luxury goods categories. While jewellery also provides aesthetic and emotional appeal, hard luxury consumers generally judge a jewellery piece based on the intrinsic value of its gemstones. As hard luxury pieces are not subject to the same potential wear and tear as soft luxury items, hard luxury pieces are not only purchased for consumption but also as “investments of passion” given their emotional and aesthetical appeal and their potential to increase in value as the value of underlying gemstones appreciates over time.

Jewellery, gems, and watches account for the second highest share of high net worth individuals’ “investments of passion” and are part of a subset of rare, non-depreciating “investments of passion” that includes fine art, fine wine and classic cars. These assets’ sharp price appreciation in recent years, together with similar trends seen for large diamonds, are responsible for growing investor interest in these alternative asset classes. We believe investors’ acceptance of these alternative stores of wealth is more widespread than ever, and expect it to contribute to further demand for our jewellery.

Global Sales

The following graph illustrates the historical evolution, as well as the forecast development, of the overall global luxury goods market by geographical region between 2005 and 2014F. For the purpose of the geographical breakdown, sales are recorded in the geographical region where they occur. Due to the mobility of luxury goods consumers, physical sales in a particular geographical region do not necessarily indicate the origin or nationality of the consumers.
Europe is the largest geographical region with approximately €69 billion of sales in 2011E. European luxury goods sales have recovered quickly from the global financial crisis with 10% growth in 2010 and 7% growth in 2011E. Growth in 2010 and 2011E was fuelled by strong organic growth in the local population’s consumption of luxury goods, with Western Europe compensating for lower growth in Eastern Europe. The weaker Euro and rising global tourism provided an additional driver for growth, as “travelling luxury consumers”, particularly from China, made significant purchases in Paris, London and Milan, which are well known as centres of the luxury goods industry. These consumers are estimated to account for up to 50% of sales in these cities. These consumers are expected to continue to be a main driver of growth in the region.

Asia, excluding Japan, is the fastest growing of any geographical region. Asia generated sales of approximately €36 billion in 2011E and represented 19% of the global luxury goods market, nearly double the 10% share the region had in 2005.

Chinese demand has been the key driver of growth in Asian demand for luxury goods. Sales of luxury goods in China have nearly tripled from €4.5 billion in 2007 to €12.9 billion in 2011E, a CAGR of approximately 30%, driven by strong GDP growth, growing urbanisation, and the fast-paced expansion of European and American luxury brands’ retail networks. China is the largest luxury goods market in the region, accounting for approximately 36% of regional sales and 7% of the global luxury goods market. Due to high taxes on imported luxury items and the increasing propensity of Chinese consumers to travel overseas, luxury goods sales within country only capture a portion of total Chinese demand for luxury goods. It is estimated that globally, Chinese consumers account for approximately 20% of global luxury consumption once sales in Hong Kong, Macau, and Taiwan (i.e. Greater China) and estimated tourist spend outside of greater China are included.

In the coming years, Asia is expected to grow faster than all other regions, driven by favourable demographic trends and strong economic growth in China. The number of very wealthy households in China with household income of more than RMB1 million (approximately US$159,000) and typically owning assets greater than RMB10 million (approximately US$1.6 million) is expected to grow by approximately 20% per annum, to reach 1 million households by 2015F (source: McKinsey Insights: China – Understanding China’s Growing Love for Luxury). The increase in wealth, combined with continued rapid urbanisation, is expected to double the number of cities with sizable pools of luxury goods

Note: 2014F figures are at constant 2011E exchange rates
Source: Bain Luxury Study — Altagamma Worldwide Market Monitor
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consumers to 60 over the next five years (source: McKinsey Insights China — Understanding China’s Growing Love for Luxury). As a result of these dynamics, luxury goods sales in China are expected to grow at an approximately 20% CAGR from 2011E through 2014F.

The Americas is the second largest geographical region with $57 billion of sales in 2011E, with the United States accounting for the vast majority of this region’s sales. Luxury goods sales in the region have, at times, been obscured by the depreciation of the United States dollar relative to the Euro in the period examined by the Bain Luxury Study — Altagamma Worldwide Market Monitor studies.

Japan was the only geographical region to demonstrate negative growth from 2005 to 2011E. While growth in luxury goods sales is expected to be positive from 2011E to 2014F, Japan’s share of the global luxury goods market is expected to decline.

Absolute Luxury Segment Geographical Distribution

The geographical breakdown of the absolute luxury segment differs from the overall global luxury goods market. As shown in the following graph outlining the 2011E breakdown by geographical region for the absolute luxury segment and the overall luxury goods market, the starkest difference is in the Americas and Europe. This variation is the result of the nature of American and European luxury brands; most American luxury brands are found within the accessible and aspirational luxury segments, while Europe has a disproportionally higher concentration of absolute luxury brands. As these brands still generate a large portion of their sales in the European regions, the geographical mix of the absolute luxury segment accordingly shows a European concentration.

Exhibit 8: Global luxury goods market by geographic region: 2011E

<table>
<thead>
<tr>
<th></th>
<th>Global Luxury Market</th>
<th>Absolute Luxury Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Americas</td>
<td>30%</td>
<td>22%</td>
</tr>
<tr>
<td>Asia</td>
<td>19%</td>
<td>21%</td>
</tr>
<tr>
<td>Europe</td>
<td>36%</td>
<td>44%</td>
</tr>
<tr>
<td>Japan</td>
<td>10%</td>
<td>9%</td>
</tr>
<tr>
<td>RoW</td>
<td>5%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: Bain Luxury Study — Altagamma Worldwide Market Monitor, Spring Update (April 2012)

Diamond Industry Overview

Diamonds account for approximately 40% in terms of value of all jewellery manufacturing with engagement rings being the largest category within diamond jewellery. Diamonds have long been prized for their rarity and beauty. This section discusses the industry’s history, the diamond value chain, diamond pricing dynamics, global diamond demand, and the outlook for the diamond industry.

History

The discovery of massive diamond deposits in South Africa in the 1870s formed the basis for the modern diamond industry. The South Africa-based De Beers Group quickly consolidated the diamond industry to create a de facto monopoly over mining, trading and marketing.

Diamonds had long been associated with wealth, status and well-being, but due to the efforts of De Beers, diamonds became strongly associated with romantic love. In the 1940s, De Beers launched the well known “Diamonds are forever” marketing campaign. The campaign utilised traditional advertisement channels as
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well as sponsorship and endorsement arrangements with the entertainment industry. The entire diamond industry benefitted from the campaign, as demand for diamond engagement rings grew steadily, first in the United States and then other markets, including Japan. A similar trend is now being seen in China where demand for diamond engagement rings has risen sharply but has not yet reached the penetration levels seen in the United States and Japan.

Exhibit 9: Percentage of engaged women receiving diamond engagement rings

Source: De Beers

Production of diamonds was originally centred in South Africa but has since expanded across the world. Initial expansion was into other African countries, but has since spread to Russia, Australia and Canada. Today, Botswana, Russia, Canada and South Africa are the world’s largest diamond producing countries by value.

Exhibit 10: Since the 1960s, significant production started in Russia, Australia and Canada

Source: Bain Diamond Report (December 2011)

As production expanded into other countries, De Beers maintained control over the industry either through direct and indirect ownership of the mines, or through agreements with other producers to sell
their rough diamonds through De Beers’ marketing arm, the Diamond Trading Company (“DTC”). Following large discoveries of diamonds in Russia in the 1950s, the agreement between the USSR and the DTC was particularly important to DTC’s continued control of the diamond trade.

Continued expansion of production at non-De Beers mines throughout the 1960s to 1980s posed a challenge to DTC’s dominance, as some producers and dealers began circumventing the DTC system. In the 1990s, major producers left the DTC to begin selling diamonds independently through their own trading organisations or at spot sales and auctions. By the early 2000s, the DTC’s role had been reduced, but it still accounted for the majority of wholesale rough diamond sales. This majority ended following De Beers commitment to the European Commission to end the DTC’s purchase of rough diamonds from Alrosa, Russia’s largest diamond producer and successor to the USSR’s diamond monopoly. While the DTC retains a preeminent role in the trading of rough diamonds, the industry has evolved with many producers running their own system of long-term contracts.

Exhibit 11: Even though the share of sales through the DTC has been falling, long-term contracts still constitute the largest sales channel of rough diamonds

Against this backdrop, De Beers refocused its strategy to becoming a leader in driving consumer demand through the implementation of its “Supplier of Choice” program in 2003. The program shifted some of the responsibility for marketing to DTC sightholders as a precondition for access to DTC’s still ample diamond supply. The program focused on 1) value addition through the downstream integration of sightholders into cutting and polishing, jewellery manufacturing and promoting and marketing their own brands; 2) marketing and branding through promotion of sightholders’ own brands so De Beers could focus its marketing on its Forevermark brand; and 3) maintaining consumer confidence and trust by holding sightholders to specific ethical business standards. At the same time, De Beers entered the retail sector through a joint venture with LVMH that created the LVMH-managed De Beers Diamond Jewellers, which does not receive a direct flow of diamonds from the DTC.

At the same time as De Beers underwent its strategic shift, the diamond industry faced another challenge in the form of “conflict diamonds”. Throughout the 1990s, armed conflict in various African diamond producing countries had led to diamond mines falling into the hands of groups that used diamond proceeds to fund violence. As the atrocities in these countries mounted, the reputation of the industry came under pressure. In response, the industry set up the Kimberley Process under the aegis of the United Nations. The scheme binds its member nations and participants, which represent 99.8% of total diamond supply, to certify the source of all diamonds entering the supply, refrain from trading with non-participants, and provide auditable data on their production, exports, and imports. As a result of the Kimberley Process, conflict diamonds now account for less than 1% of global trade compared to the estimated 4% share before the implementation of the scheme 10 years ago.
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The Diamond Industry Value Chain

There are eight distinctive stages of the diamond value chain, beginning with exploration and production and ending with retail sales to the end consumer. The value chain is primarily composed of thousands of privately held small businesses and individuals that form the core of a complex and fragmented distribution system, with a handful of larger public and private companies sitting at each end of the value chain.

Exhibit 12: Diamond industry value chain

As diamonds pass through the value chain, their value increases by approximately five times from US$12 billion at the production stage to US$60 billion at the retail stage; however, only incremental value addition is seen until the manufacturing and retail stages, where nearly 90% of the post-mining and production value addition takes place.

The clustering of larger companies at each end of the value chain is a result of the value addition dynamics and the industry margin structure. Margins in the middle of the chain are generally thin given the low value addition as well as the highly competitive structure.

Exploration

The exploration stage is the most risky in the value chain. Exploration requires substantial financial investment over a six to ten year period and the odds of developing a commercially viable diamond mine are low. Of the approximately 10,000 kimberlites discovered to date, only 1,000 have proven to be diamond bearing and only 100 have been developed into commercially viable mines, a success rate of approximately 1%. Historically, diamond producers shouldered the majority of the exploration investment, but recently large producers have cut back their exploration investment to focus on optimising their current resources. In their place, smaller producers and diamond focused exploration companies have stepped in to bear the initial risk, in the hope of developing sites that can then be sold to major producers.

Mining and Production

Mining and production of rough diamonds takes place at approximately 20 major mines worldwide. Approximately three quarters of this production by value takes place in Botswana, Russia, Canada and South Africa, with a handful of other countries producing the remainder.

Botswana is playing an increasingly important role within the industry. The country has some of the largest and most valuable diamond mines in the world, including Jwaneng and Orapa. The Botswana government is a large stakeholder in the diamond industry, with notable investments including 50% ownership stakes in Jwaneng and Orapa as well as 15% ownership of De Beers (source: De Beers). The government has also taken an active role in the development of the domestic diamond industry, encouraging the development of the Graff-owned Gaborone Diamond Technology Park that serves as the country’s diamond hub and the new site to which the DTC has relocated its London sight.
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Exhibit 13: Botswana and Russia top the list of world diamond producers

Production is highly concentrated within the hands of a few players. Alrosa and De Beers (due to be majority owned by Anglo-American), the two largest players, contribute close to 70% of production, followed by Rio Tinto and BHP Billiton, which together account for 15%. Smaller players, including Gem Diamonds and Petra Diamonds, contribute the remaining production.

Exhibit 14: Estimated world rough diamond sales (including sale of stocks), US$ billions

Large diamonds generally achieve a much higher price per carat due to their rarity, as seen by the disproportionate amount of value generated from a relatively small contribution by volume.
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Exhibit 15: Large diamonds account for less than 5% of volume but 50% of value of the total diamond market

Structure of diamond production at a typical mine, in volume and value terms

<table>
<thead>
<tr>
<th>Volume</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;2 Carats 5%</td>
<td>&gt;2 Carats 50%</td>
</tr>
<tr>
<td>0.1-2.0 Carats 45%</td>
<td>0.1-2.0 Carats 30%</td>
</tr>
<tr>
<td>&lt;0.1 Carat 50%</td>
<td>&lt;0.1 Carat 20%</td>
</tr>
</tbody>
</table>

Source: Bain Diamond Report (December 2011)

Rough Diamond Sales

Producers distribute rough diamonds into the market through three channels: long-term contracts (also known as the sightholder system), auctions, tenders and spot sales. The sightholder system offers more price stability to both producers and sightholders while prices achieved through auctions, tenders and spot sales are subject to short-term market dynamics and associated volatility. Under the sightholder system, producers sell to the holders of long-term contracts, or sightholders, on a regular basis at prices set at a regular interval by the producer. Producers sell the diamonds in boxes of predetermined quantity and quality tailored to the needs of the sightholder’s business and the sightholders can only accept or reject the whole box, although there is some scope for sightholders to return a small portion of the box once opened. De Beers and the DTC originally developed the sightholder system but, as the DTC’s power waned, other producers have developed similar programs. Being a sightholder confers a distinct advantage, as fewer than 100 sightholders work with the major producers and buy more than 70% of global diamond production.

Exhibit 16: There are several ways to market rough diamonds

Share of diamond value at wholesale, 2010

<table>
<thead>
<tr>
<th>Share (in %)</th>
<th>De Beers</th>
<th>ALROSA</th>
<th>BHP Billiton</th>
<th>Rio Tinto</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.1*</td>
<td>3.3*</td>
<td>1.3*</td>
<td>0.7*</td>
<td>1.9*</td>
<td></td>
</tr>
</tbody>
</table>

Note: Does not include all sales from artisanal and illicit production

* Global rough diamond sales (including sale of stocks), US$ billion
Source: Bain Diamond Report, (December 2011)
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Exhibit 17: Fewer than 100 independent sightholders exist worldwide

Number of sightholders for each diamond producer, 2011

Auctions, tenders and spot sales are conducted without long-term contracts that manage short-term fluctuations in diamond prices. Accordingly, auctions, tenders and spot sales offer the flexibility to take advantage of high diamond prices but conversely suffer more when diamond prices fall. Auctions historically functioned as an outlet only for larger diamonds but have gained in popularity and now typically operate similarly to sights with buyers purchasing boxes of diamonds. Spot sales are usually done on a one-to-one basis to non-exclusive buyers. Spot sales are particularly useful for rare and unique diamonds that have a limited number of potential buyers given their cost and the expertise required to successfully cut, polish, and sell the diamond. As producers will often contact only the most likely buyer directly, market reputation, established relationships with producers, and recognised expertise in handling rare and unique diamonds are critical to a buyer’s success in the spot sales channel.

Cutting and Polishing

The cutting and polishing stage involves the transformation of rough diamonds into polished diamonds. Skilled craftspeople, known as lapidaries, employ traditional methods and increasingly three-dimensional technologies to determine the cut of a diamond that will maximise its value. Historically centres in Antwerp, Israel, the United States and Russia dominated cutting and polishing.

The cutting and polishing industry in Africa has grown rapidly. Low-cost labour and governmental regulations mandating a certain percentage of local cutting and polishing have encouraged major participants to develop facilities in South Africa and Botswana, including the Gaborone Diamond Technology Park that serves as the hub for cutting and polishing and other diamond activities in Botswana. Examples of these regulations include the South African government’s requirement that any rough diamond mined in South Africa and weighing more than 10.8 carats must be polished or partially polished in South Africa before it can be exported.

Polished Diamond Sales

Once cut and polished, cutters and polishers sell the polished diamonds to jewellery manufacturers. Historically, this trade was centred in Antwerp. While Antwerp is still an important centre, central and regional offices of diamond cutters and polishers now account for more than half of polished diamond sales. Industry exhibitions, the most important of which take place in Hong Kong, Las Vegas and Basel, account for roughly 30–40% of polished diamond sales.

Jewellery manufacturing

Jewellery manufacturing is highly fragmented, with more than 10,000 manufacturers globally. Low-cost labour in China and India has precipitated a shift in manufacturing to these countries, which now account
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for approximately half of global jewellery manufacturing by value. Generally, most Asian manufacturers work at the low-end of the market and produce unbranded pieces.

According to Bain Diamond Report (December 2011), diamond jewellery manufacturing falls into the following categories: integrated specialised manufacturers, luxury brand manufacturers, regional retailers and non-integrated manufacturers, and non branded manufacturers. The top-end of the market includes luxury brands such as Graff, Van Cleef & Arpels, Cartier, and Bulgari and large manufacturers such as Tiffany & Co. For luxury branded pieces, the manufacturing cost related to the jewellery setting is often minor compared to the value of the diamonds incorporated into the final product, even for the most complicated jewellery pieces. This cost structure is particularly true for pieces incorporating large diamonds due to larger diamonds' higher average price per carat. As with other industries, the premium associated with branded luxury pieces is significant when compared to unbranded items of similar size and quality.

Retail

The retail stage is highly competitive, with a level of fragmentation greater than any other stage in the chain. Over 250,000 retailers sell jewellery around the world with no dominant player in most countries. Despite fierce competition, retailers enjoy high mark-ups and consequently margins due to the emotional element associated with diamonds as well as the relative complexity of diamond pricing. Over the last ten years, there has been a pronounced shift in the retail landscape with independent jewellers losing a 14% market share. The two main beneficiaries have been global retail chains, especially in Asia, that have gained a 7% market share and online retail, which has gained a 5% market share. While online retail remains the smallest distribution channel, the Internet has introduced greater price transparency into the market as consumers inform themselves better about diamond pricing before making their purchase. As a result of these changes, the retail stage has seen consolidation among smaller players as well as larger players diversifying their businesses through expansion into higher-growth emerging markets.

Diamond pricing

No two diamonds are the same. The lack of homogeneity in diamonds had long proven an impediment to determining the value of a diamond as diamonds cannot be traded on commodity indices in the same manner as precious metals such as gold, silver, or platinum. However, the introduction of an industry accepted classification and certification system by the GIA has mitigated the difficulty in pricing diamonds. As a result of the classification and certification system, the continually increasing diamond market size, and the expanding number of industry players, diamond prices are more democratic than ever before.

Polished diamonds are generally classified using the 4Cs as defined by GIA: carat, colour, clarity and cut.

- The carat is the standard unit of measurement for diamonds. The modern metric carat is the same across the world and is equivalent to 0.2 grams.
- Colour is an important determinant of a diamond’s value. In general, the best diamonds are colourless; the exception is fancy diamonds, which are diamonds that naturally occur in various colour shades and are highly valued due to their rarity. The industry standard for grading a diamond’s colour is the scale developed by the GIA. The scale begins with D, representing colourless diamonds and continues with increasing colour to Z. Fancy diamonds lie outside of this scale and are graded based on colour intensity with designations such as “fancy light”, “fancy intense”, and “fancy vivid”.
- Clarity refers to the absence of inclusions within the diamond and blemishes on the exterior of the diamond. The industry standard for grading a diamond’s clarity is the scale developed by the GIA. The scale contains 11 grades: flawless, internally flawless, very very slightly included (VVS1 and VVS2), very slightly included (VS1 and VS2), slightly included (S1 and S2), and included (I1, I2, and I3).
- Cut refers to both the shape and the proportions of a diamond. Understanding the cut begins with the shape. The archetypal diamond shape is known as the standard round brilliant. All other shapes are known as fancy shapes. The most well known fancy shapes are emerald, pear, oval, heart, and marquise. Standard round brilliant diamonds have 58 facets and the best cuts are those that maximise
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the amount of light that is refracted through the different facets. The GIA classifies cut using a scale of excellent, very good, good, fair and poor, as well as a classification for polish and symmetry. Once classified and certified, diamonds can be valued based on current pricing conditions in the market, which are tracked by a handful of indices, the most important being the Rapaport Price List, which is considered the authority for polished diamond prices. Polished diamond prices are often quoted as a discount or premium to the prices published in the Rapaport Price List.

Rough Diamond Pricing

Rough diamond pricing is set by major producers via sights and auctions. Historically, the key drivers of rough diamond price performance have been major macroeconomic trends and industry supply and demand dynamics. The major economic crises of the last 30 years have all had negative effects on rough diamond prices as concerns about consumer demand, financing and short-term rough diamond oversupply put downward pressure on demand for rough diamonds. Following these crises, prices have returned to normal growth trends relatively quickly.

Exhibit 18: Historical rough-diamond pricing

Polished Diamond Pricing

While industry dynamics at the rough diamond level do affect wholesale polished diamond prices to a certain extent, polished diamond prices exhibit less volatility than rough diamond prices. Although intense competitive pricing in the middle of the value chain tends to partially absorb rapid price fluctuations, polished diamonds generally follow the directional trend of rough diamonds, especially in periods of supply and demand imbalances.

Consumer demand is the most important lever for polished diamond pricing, with total private consumption and middle class population growth being key indicators of polished diamond demand. Inventories do not play a major role in determining polished diamond prices due to the level of fragmentation as well as the need for cutters and polishers to turn inventory quickly to meet their financing obligations.
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Exhibit 19: Historical polished diamond pricing

Pricing trends vary significantly depending on diamond quality and size. Large diamonds are much rarer than smaller stones. Some have gained worldwide recognition, including the Graff Constellation, the Graff Pink, the Delaire Sunrise, the Wittelsbach-Graff, the Magnificence and the Lesotho Promise, and very few of these large diamonds come back to market once sold. During periods of diamond price appreciation, large diamonds tend to increase in value at a much faster pace than small diamonds. As a result, supply and demand imbalances for large diamonds have led to sharper price increases than when imbalances occur for smaller diamonds.

Exhibit 20: Evolution of polished diamond price depends on size of the stone

Diamond demand in the global economy

Diamonds are the second largest category of jewellery by value after gold. The global retail market for diamond jewellery is worth approximately US$60 billion per year. The United States is the largest market for diamond jewellery but the Asian and other emerging markets have shown the most rapid growth in the last decade. The use of diamonds varies widely based on regional cultural specifics, with diamond jewellery accounting for a much smaller percentage of the jewellery market in Europe and China than it does in the United States and Japan.
Exhibit 21: The United States dominates consumption of diamond jewellery, but Asia has been growing fast

Demand for diamond jewellery in major markets, 2010
US$ billions

While diamond consumption was negatively impacted by the financial crisis, the market quickly recovered in 2010 with 14% growth. Extraordinary growth in emerging markets underpinned the strength of this recovery. Going forward, demand for diamond jewellery is expected to grow at a 5.6% CAGR from 2010 to 2020, with China and India providing the main engine for growth (source: Alrosa). We believe additional demand is expected to be generated as the popularity of diamonds, especially rare large diamonds, as an alternative investment asset increases.

Exhibit 22: Developing markets are growing their share of overall consumption of gem quality diamonds

Diamond consumption, in value*
US$ billions

* Wholesale value of polished diamonds used in diamond jewellery; Includes sale of stocks; wholesale value of diamonds; China includes Hong Kong
Source: Bain Diamond Report (December 2011)
INDUSTRY OVERVIEW

Exhibit 23: Diamond jewellery consumption by region (US$ billions)

<table>
<thead>
<tr>
<th>Region</th>
<th>2010</th>
<th>2015E</th>
<th>2020E</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>73.8</td>
<td>97.4</td>
<td>127.8</td>
</tr>
<tr>
<td>Japan</td>
<td>5.0</td>
<td>7.2</td>
<td>10.0</td>
</tr>
<tr>
<td>India</td>
<td>7.9</td>
<td>8.8</td>
<td>11.0</td>
</tr>
<tr>
<td>China</td>
<td>28.5</td>
<td>35.7</td>
<td>44.5</td>
</tr>
<tr>
<td>World</td>
<td>73.8</td>
<td>97.4</td>
<td>127.8</td>
</tr>
</tbody>
</table>

CAGR (2010–2020)

<table>
<thead>
<tr>
<th>Region</th>
<th>USA</th>
<th>Japan</th>
<th>India</th>
<th>China</th>
<th>World</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>5.6%</td>
<td>4.7%</td>
<td>2.4%</td>
<td>11.0%</td>
<td>5.6%</td>
</tr>
<tr>
<td>2015E</td>
<td>12.5%</td>
<td>11.0%</td>
<td>2.4%</td>
<td>12.5%</td>
<td>12.5%</td>
</tr>
<tr>
<td>2020E</td>
<td>11.0%</td>
<td>11.0%</td>
<td>2.4%</td>
<td>12.5%</td>
<td>12.5%</td>
</tr>
</tbody>
</table>

Source: Alrosa Investor Presentation (October 2011)

Ten year supply and demand imbalance

All forecasts in this section are derived from the Bain Global Diamond Industry report published in December 2011. Due to the nature of these assumptions underlying these forecasts that cannot be controlled, as well as the macroeconomic and demographic factors, there can be no assurance that these forecasts will be met.

Over the next decade, demand for rough diamonds is expected to grow significantly faster than the supply of rough diamonds. The expected supply and demand imbalance bodes positively for rough diamond producers and could potentially lead to longer-term price increases.

Rough diamond supply in carats is forecast to grow at a 2.8% CAGR from 2010 to 2020 in the base case scenario. Key factors affecting the low growth rate are relatively flat production at the major producers, depletion of existing mines, a relatively small pipeline for new mines and the significant lead-time that would be required to bring any newly discovered diamond deposits online.

Exhibit 24: Total supply is forecast to reach 170–175 million carats

* Based on the planned addition of 23 million carats of diamonds from new mines now being developed, slight depletion of existing diamond resources and a lack of any significant new discoveries in recent years

Smaller players include Catoca mine, BHP Billiton, Petra Diamonds and Harry Winston; other mines include all the remaining production in Angola, Australia, Canada, Democratic Republic of the Congo, Russia, South Africa, Zimbabwe and other minor producing countries

Source: Bain Diamond Report (December 2011)

Consumer demand is the most significant driver of the rough diamond demand forecast. In developed regions where income distributions are relatively stable, the key driver of demand will be growth in total...
private consumption. In developing countries such as China and India, growing urbanisation and the rise of the middle class will be the key determinants of demand growth. Overall, diamond demand in carats is expected to grow at a 6.4% CAGR from 2010 to 2020 in the base case scenario.

**Exhibit 25:** Rough diamond demand is forecast to grow at 6.6% CAGR per year in value terms

The forecasts point to a likely imbalance in supply and demand of rough diamonds through 2020. Under the forecasted scenarios for 2010 through 2020, demand will be higher than supply by value. In the base case scenario, demand by value will grow at a 6.6% CAGR while supply by value will grow only at a 3.0% CAGR. Historically, supply-demand imbalances of this nature have provided the basis for a firm price environment.

**Exhibit 26:** Global rough-diamond supply-demand balance 2011–2020