

RAPAPORT MONTHLY REPORT

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November 2016

Trading Slow as Focus Turns to Retail

Executive Summary

The fourth quarter began with quiet diamond trading as many wholesale businesses were closed for the Jewish holiday period in October. Similar conditions are expected in November with Indian manufacturers and dealers on vacation during Diwali, which began on October 30.

Polished prices softened as inventory in the midstream remained high and trading activity was low. The RapNet Diamond Index (RAPI™) for 1-carat, RapSpec-A3+, polished diamonds fell 2.3 percent in October (see Figure 1). RAPI for 0.30-carat diamonds declined 0.5 percent, while RAPI for 0.50-carat diamonds slid 1.6 percent. RAPI for 3-carat diamonds firmed up 1.2 percent.

Rough demand declined as manufacturing units closed for Diwali and large-scale orders from jewelry retailers were already filled for the holiday period. Rough prices increased on select boxes at the De Beers sight and ALROSA sale respectively, while premiums fell on the secondary market. Manufacturing profit remains tight and rough prices are expected to be stable during the rest of this year.

The industry's focus has shifted to retail, as Diwali, Christmas and the Chinese New Year represent the strongest selling period in each of the major consumer markets. We expect moderate growth in U.S. jewelry sales over Christmas and relative stability in Mainland China for the Chinese New Year, which begins January 28. Initial reports signaled strong gold jewelry sales on Dhanteras (October 28), an auspicious day for buying gold that marks the beginning of the Diwali festival.

We expect polished prices to remain under pressure as consumer holiday demand is unlikely to stimulate significant restocking across the diamond pipeline. Polished trading is likely to be stable in November and December as dealers fill last-minute orders for the season. However, with sufficient stock in the midstream, the diamond trade continues to re-align its inventory with lower levels of demand while there is still an overhang of supply from previous years.

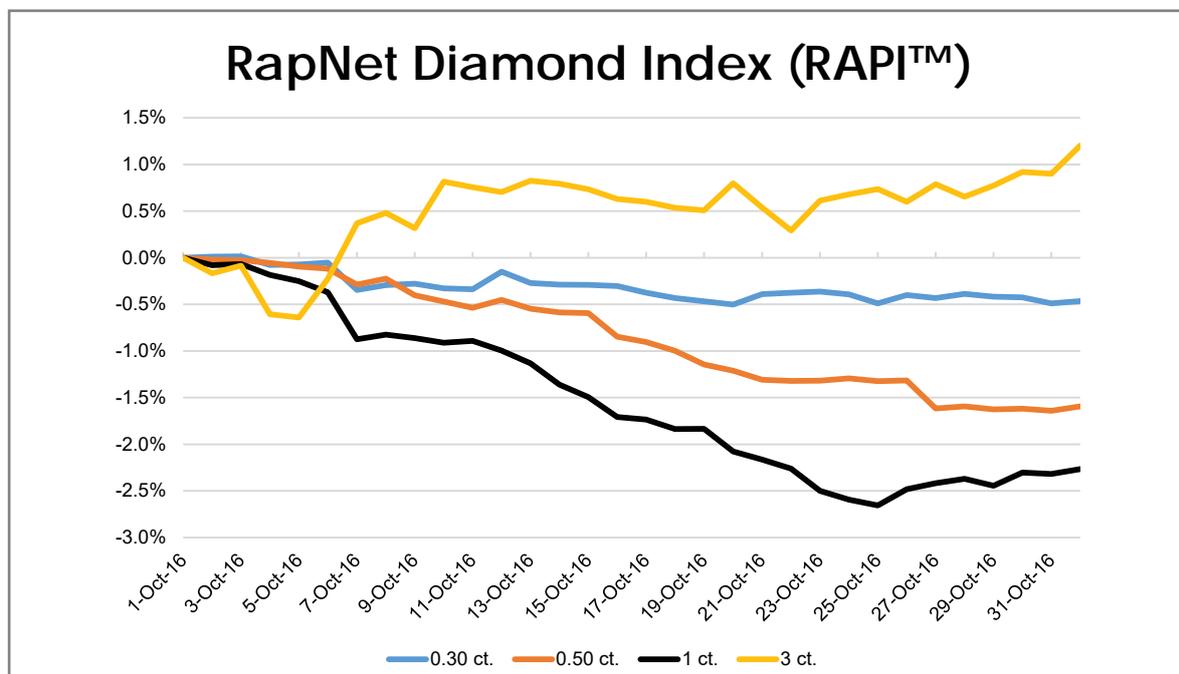


Figure 1

The RapNet Diamond Index (RAPI™) is the average asking price in hundred \$/ct. of the 10 percent best priced diamonds, for each of the top 25 quality round diamonds (D-H, IF-VS2, GIA-graded, RapSpec-A3 and better) offered for sale on RapNet - Rapaport Diamond Trading Network.

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The Polished Market

Polished prices have declined since the beginning of the year, with RAPI for 1-carat diamonds down 4.2 percent in the first ten months (see Figure 2). The last two months are traditionally slower periods in the polished dealer market, as large-scale orders for the holiday season have already been filled and dealers concentrate on filling specific last-minute orders. We, therefore, don't expect an upturn in polished prices in November or December.

Trading was slow in October for the same reason. Indian manufacturers completed their orders before Diwali, which began on October 30, when factories close for two-to-four weeks. In addition, businesses in Israel, and many in New York and Antwerp, closed during the Jewish holidays.

Inventory levels were steady during the month. The number of unique stones listed on RapNet edged up 0.5 percent to 1.26 million diamonds, while the value of RapNet inventory increased 1.4 percent to \$9.8 billion. RapNet inventory jumped 23 percent by volume and 9 percent by value since the beginning of the year.

Inventory levels are projected to decline slightly in November while polished production slows during Diwali.

Polished Headlines

- ❖ India's Sep. polished exports +30% to \$2.5B, polished imports -21% to \$185M.
- ❖ Belgium's Sep. polished exports -11% to \$1.2B, polished imports -5% to \$1.3B.
- ❖ U.S. Aug. polished imports +2% to \$1.7B, polished exports +3% to \$1.4B.
- ❖ Sotheby's Hong Kong fetches \$25M as jadeite bangle (with pre-sale estimate of \$6.4M to \$9M) fails to sell.
- ❖ Swiss watch Sep. exports -6% to \$1.7B.

RapNet Diamond Index (RAPI™)			
	October	YTD Jan. 1 - Nov. 1	Y2Y Changes at Nov. 1
RAPI 0.30 ct.	-0.5%	-0.2%	6.4%
RAPI 0.50 ct.	-1.6%	1.9%	5.4%
RAPI 1.00 ct.	-2.3%	-4.2%	-2.8%
RAPI 3.00 ct.	1.2%	-8.7%	-9.3%

Figure 2

The RapNet Diamond Index (RAPI™) is the average asking price in hundred \$/ct. of the 10 percent best priced diamonds, for each of the top 25 quality round diamonds (D-H, IF-VS2, GIA-graded, RapSpec-A3 and better) offered for sale on RapNet - Rapaport Diamond Trading Network.

Sentiment was positive in the trading centers as activity improved since the Hong Kong Jewellery & Gem Fair in September. Dealers were focused on filling holiday orders with steady U.S. demand for 0.20 to 0.70-carat, H-K, SI-I2 diamonds. Demand for stones weighing 1-carat or above was slower. Demand for melee improved, while stars remained weak.

Trading in India improved, with Israeli and U.S. dealers looking for goods before the Mumbai market closed for Diwali. Demand was largely geared toward the U.S. market, while there was also some pent-up Chinese demand.

India's polished exports jumped 15 percent in the third quarter, traditionally its strongest period, to meet U.S. holiday demand (see Figure 3). Meanwhile,

Belgium's polished exports and imports both dropped 9 percent during the quarter signaling a continued decline in the country's polished trade (see Figure 3). Belgium's exports to all major trading and consumer centers declined in the first nine months of the year.

Israeli dealers maintained their focus on the U.S. market during Israel Diamond Week, which started on October 31 at the New York Diamond Dealers Club.

As the focus has shifted to the retail selling season, polished dealers are hoping Christmas and the Chinese New Year will stimulate stronger trading in 2017. For now, polished trading is expected to remain relatively quiet in November and December.

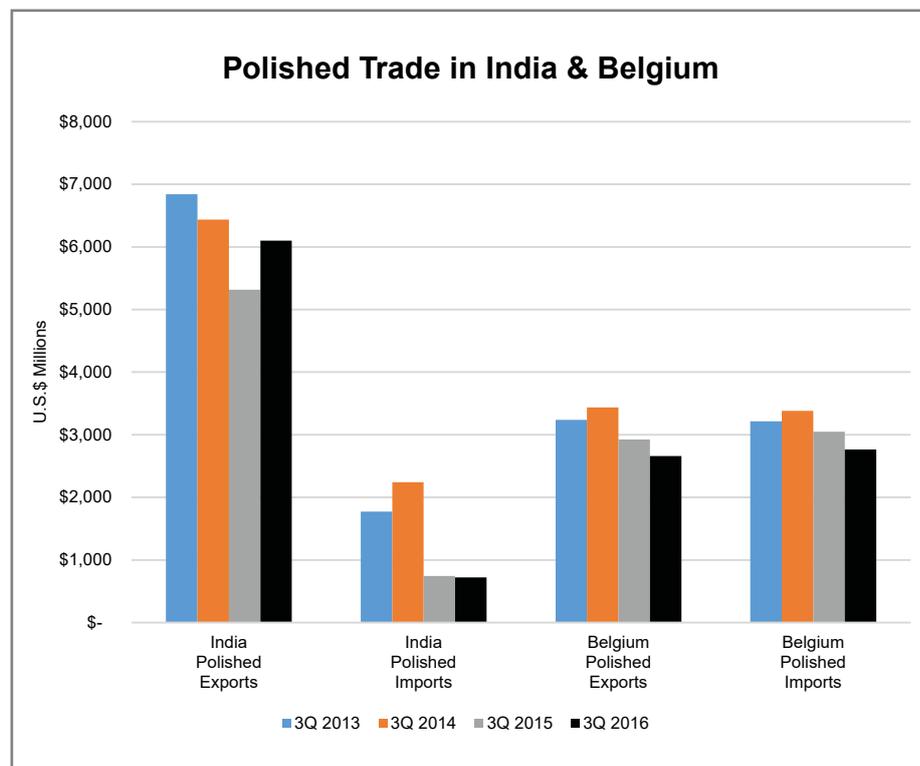


Figure 3

Based on monthly data published by India's Gem and Jewellery Export Promotion Council (GJEPC) and Belgium's Antwerp World Diamond Centre (AWDC).

The Rough Market

The supply of rough diamonds declined in October as Indian manufacturers scaled down production before closing for Diwali. We believe rough demand should remain relatively muted in the final months of the year as polished inventory remains high and a large volume of rough that was sold in the third quarter is yet to be processed.

De Beers recorded rough sales of \$485 million during October. While that's the lowest level for this year, it's a 57 percent jump from a year ago, as estimated by Rapaport.

The mining companies continue to report strong sales growth this year. The percentage gains in the second half are being facilitated by the low-base effect from last year when rough demand plummeted due to low profit margins and excess polished in the midstream.

De Beers sales volume jumped 90 percent to 5.7 million carats in the third quarter, while its sales value increased 27 percent to \$4.7 billion across the first eight sales cycles of the year. With two more sales left

Rough Headlines

- ❖ De Beers 3Q production +4% to 6.3M cts., sales volume +90% to 5.7M cts.
- ❖ De Beers sells \$485M in Oct. sales cycle.
- ❖ ALROSA 3Q revenue +73% to \$976M, production -6% to 10.96M cts.
- ❖ Rio Tinto 3Q diamond production +3% to 4.4M cts., reduces 2016 outlook to 18 to 20M cts.
- ❖ Petra Diamonds 1Q production +30% to 1.1M cts., sales at \$95M.
- ❖ Catoca 2015 revenue -4% \$582M, profit +0.6% to \$126.8M, production +4% to 6.7M cts.
- ❖ India's Sep. rough imports +71% to \$1.8b, rough exports +131% to 155M.
- ❖ Belgium's Sep. rough imports +39% to \$1.2B, rough exports +61% to \$1.4B.
- ❖ Stomway launches Renard diamond mine in Canada.

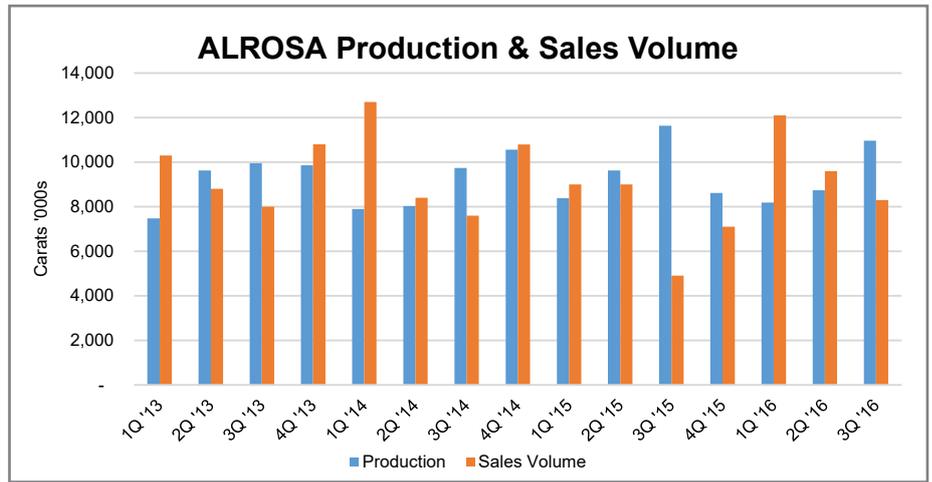


Figure 4
Based on published ALROSA reports and Rapaport estimates.

in 2016, the company is on track to record rough sales of about \$5.5 billion, compared with \$4.1 billion recorded in 2015. That, along with fourth quarter production anticipated at about 7 million carats – the same level as a year ago – will help De Beers reduce inventory that built up during 2015.

Similarly, ALROSA reported rough sales soared 69 percent to 8.3 million carats in the third quarter, while total sales by value jumped 73 percent to an estimated \$975 million. ALROSA reduced a large portion of inventory built up in 2015 with strong sales this year. However, it added approximately 2.7 million carats to inventory again in the third quarter as production of 10.96 million carats exceeded sales volume (see Figure 4).

Sales at De Beers and ALROSA are expected to improve in November and December as the period is traditionally stronger for rough trading relative to October. Manufacturers buy rough as they start to ramp-up production after Diwali, in order to prepare polished supply for the first quarter, when retailers typically restock following the holiday season.

However, manufacturers also bought a fair amount of rough to see them through Diwali. Rough trading was relatively strong in the third quarter with activity in the trading centers significantly higher than last year. India's rough imports were the highest on record for a third quarter (see Figure 5), signaling relatively high levels of rough inventory being processed.

Rough supply slowed but prices firmed in October as the mining companies released fewer goods to the market. Rough boxes were trading on the secondary market at slightly lower premiums of low single-digit percentages.

Of the major miners, De Beers, Rio Tinto and Petra Diamonds all raised production in the third quarter, while ALROSA is projecting higher output in the fourth quarter. Manufacturers need to refrain from excessive purchases in the final two months of the year in light of the sluggish polished market conditions, or risk holding surplus supply which will exert downward pressure on polished prices in the first quarter.

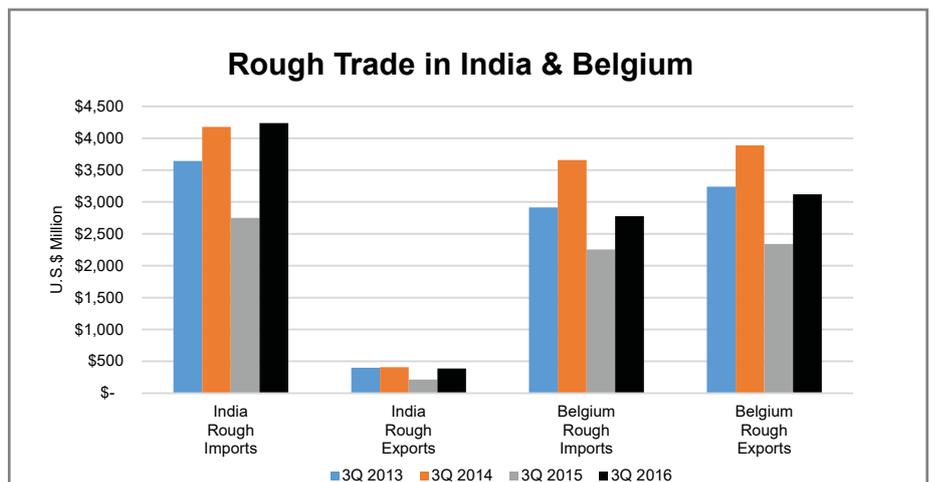


Figure 5
Based on monthly data published by India's Gem and Jewellery Export Promotion Council (GJEPC) and Belgium's Antwerp World Diamond Centre (AWDC).

The Retail Market

The fourth-quarter retail selling season began with the October 1 National Day Golden Week, signaling steady jewelry sales in Mainland China and continued weakness in Hong Kong. The major Hong Kong-based jewelers expect the pace of their retail sales declines to slow in the coming year given the lower base and poor performance last year. However, the declines still continue.

Chow Tai Fook reported sales in Mainland China fell 17 percent in the fiscal quarter that ended September 30, while sales in Hong Kong and Macau slumped 33 percent. Gem-set jewelry same-store sales dropped 17 percent in China and 23 percent in Hong Kong and Macau, while the overall performance was weighed down by steeper declines in gold sales.

Luk Fook reported similar trends, with gold sales declining due to a high comparable base last year when lower gold prices stimulated a rush for gold products. The Hong Kong jewelers have reduced the rate of store openings to accommodate the slowdown in China and changing tourist patterns in Hong Kong.

India's Diwali season got off to a positive start with gold sales on Dhanteras, the auspicious first day of the festival, up 20 to 30 percent, according to local reports. Consumers bought even as gold

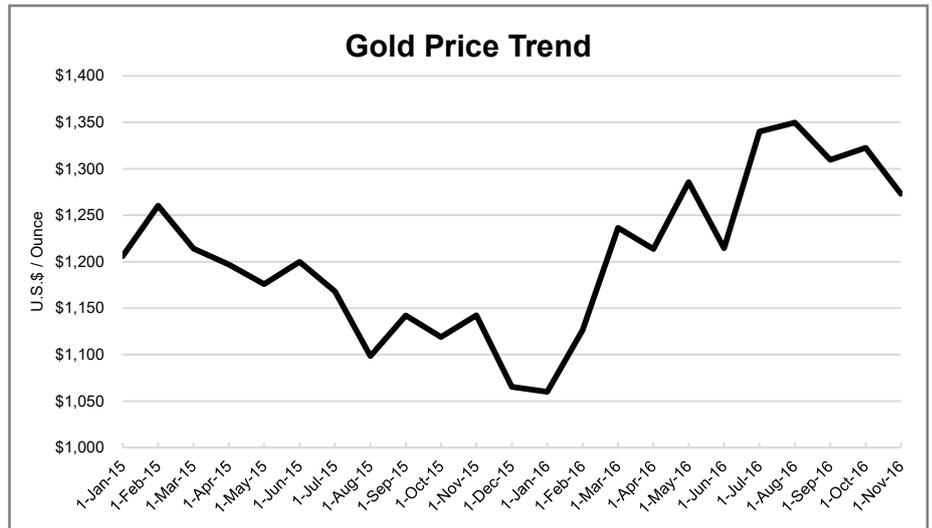


Figure 6

prices were higher this Dhanteras at around \$1,273 an ounce (INR 2,850 per gram) compared with last year when the metal was at \$1,089 an ounce (INR 2,500 per gram) (see Figure 6).

Indian jewelers noted pent-up demand from the first half when a month-long strike by jewelers and volatile gold prices kept consumers away. A good monsoon season also helped stimulate positive consumer spending for the season.

The diamond trade gives most attention, however, to the upcoming Christmas holiday season, with the U.S. accounting for an estimated 45 percent of global diamond demand, according to De Beers. The U.S. was also the strongest growth market last year, with wholesale diamond jewelry sales up 5 percent.

Slower growth is expected this year, as jewelry sales increased 1 percent to 3 percent year on year each month. Sales growth has been stimulated by higher prices with the consumer price index (CPI) for jewelry rising 6 percent from the beginning the year (see Figure 7).

The holiday marketing campaigns were launched by the industry in October, with the Diamond Producers Association (DPA) unveiling its much anticipated online videos. That said, the full impact of the program is expected to come through in the long term, rather than immediately during this holiday season. De Beers Forevermark and Signet are expected to roll out their branded campaigns in November, with the two-stone ring anticipated to feature strongly again to boost overall diamond sales this year.

Retail Headlines

- ❖ Chow Tai Fook 2Q China retail sales -17%, HK & Macau -33%.
- ❖ Luk Fook 2Q same-store sales -37%, gem-set jewelry -14%.
- ❖ LVMH 3Q jewelry sales +3% to \$966M.
- ❖ U.S. lifts sanctions on Myanmar.
- ❖ Saks to open stand-alone jewelry store.
- ❖ Diamond Producers Association (DPA) unveils 'Real is Rare' holiday video adverts.



Figure 7

Based on data sourced from U.S. government agencies.

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Rapaport RapNet Diamond Index (RAPI™)

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Additional information is available at www.diamonds.net

The Rapaport Group

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