

# Scarce diamonds take on an extra lustre for investors

*Soaring demand and falling output make the gems a sparkling performer*

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**FOR the first time in 25 years, diamond production is declining, and that may make the world's most coveted stones a better investment than copper, nickel and zinc, this year's top-performing commodities.**

Output from diamond mines worldwide is likely to fall 2 per cent by 2015, says James Picton, a diamond analyst at W. H. Ireland who has been following the industry for 35 years. Production has increased about 9 per cent in the past five years, according to the New York-based World Diamond Council, as mining companies hurried to find new deposits to meet soaring demand.

The drop in production comes as purchases of the stones rise, helped by the booming economies of China and India. China alone has doubled jewellery purchases since 2001 and may buy 20 per cent more this year, according to London research firm Diamond Forecast.

Diamonds have "the best fundamentals", said Evy Hambro, who manages the \$US6.6 billion (\$8.6 billion) World Mining Fund in London for Merrill Lynch. "The gap between supply and demand is much bigger relative to other commodities."

Rough, or uncut, diamonds don't trade on commodity exchanges. Instead, the Johannesburg-based De Beers, which sells 60 per cent of the world's uncut gems, holds 10 sales a year, known as sights, to a select group of customers called sight-holders from the diamond-cutting countries.

Ian Henderson, who manages \$US2.5 billion in natural-resource assets for JPMorgan in London, says he has increased his diamond share holdings to 4 per cent from 1 per cent in the past year.

"I am very positive about diamonds, given the overall supply-demand situation," says Henderson. "Of the 170 diamond companies out there, only 25 are actually producing."

One of those is Dublin-based African Diamonds, whose shares almost tripled this year. Another is Sierra Leone Diamond Co, a British company operating in West Africa, whose stock has also tripled.

Shares of Petra Diamonds, another UK explorer in Angola, South Africa and Botswana, have risen 52 per cent. By contrast, the Bloomberg World Mining index of 48 companies, including OAO GMK Norilsk Nickel, the world's No1 nickel producer, is up 21 per cent.

John Teeling, chairman of African Diamonds, which made its first and only diamond mine discovery two years ago in Botswana, says: "There are no big mines out there in the foreseeable future. We'd be very lucky to find a second."

Declining production is a boon for retailers. Consumers bought \$US70 billion of diamonds worldwide last year.

Retailers including De Beers and Tiffany & Co aim to increase that figure this year with new stores from Wall Street to Beijing. De Beers plans to open 20 new jewellery stores this year and next with LVMH Moet Hennessy Louis Vuitton.

The value of rough diamonds is likely to increase 30 per cent in the next six years, says James Picton. His research shows that diamonds have provided better returns than gold since 1948.

Diamonds, the hardest substance in the world, formed in primeval carbon rock structures known as kimberlites at least 150km underground. About 7000 kimberlites have been discovered but only 15 per cent bear diamonds. Since the first were discovered more than 2000 years ago in India, the world has produced 380 tonnes of diamonds.

The scarcer they are, the higher the price. The average value of the 114 million carats (50 pounds) of diamonds sold worldwide each year is little more than \$US7 billion, according to the World Diamond Council. In 2000, when 110 million carats were produced, the value was \$US7.8 billion.

"Diamonds could very well outperform base metals" in the coming years, says London fund manager Andrew Ferguson. "Given the huge increases in demand and the imbalances in supply, I expect good returns."

However, one threat to rising prices is the growth of synthetic diamonds. Since 1955, when General Electric developed a process to develop synthetic gems for use in drilling, cutting and grinding tools, the use of non-natural gems has soared, today accounting for about half of all diamonds.

Industrial use of diamonds accounted for 25 per cent of supplies by weight or 5 to 10 per cent by value, according to [www.internationaldiamond.com](http://www.internationaldiamond.com) Gemesis Corp, producer of most of the world's synthetic gem-quality diamonds, says it will raise output about eightfold in 2006 from last year to take advantage of rising prices.

The rally in commodity markets, now in its fifth year, has sent prices for raw materials to records. Copper has more than doubled in price in the past year. Nickel is up 77 per cent. Gold has surged almost 50 per cent and reached a 26-year high in May.

"To have matched the average diamond price increase since 1948 gold would have to be around \$US750," says W. H. Ireland's James Picton. "To have matched a basket of the finest, largest quality gems, gold would have to be around \$US2000."

Diamond investments will enjoy "above-average" returns in the next several years, according to Trevor Steel, who manages \$US600 million in natural resources assets at Baker Steel Capital Managers in London. "Prices of diamonds and precious metals generally are more resilient to the short-term effects of an economic slowdown compared with base metals."

Picton says falling production, led by declines at the biggest producers, including Rio Tinto's Argyle mine in Western Australia's Kimberley region, the world's largest, will leave \$US10 billion of demand unfulfilled. The drop will occur even after Botswana boosted output 17 per cent last year. The nation, the world's biggest producer of diamonds, accounts for 25 per cent of the gems.

"In order to meet the shortfall, you would have to find at least another Botswana, or better yet, two," says Picton. "It can't be done."

Canada's Ekati mine, run by BHP Billiton, will be depleted by 2015, he says. Ekati, which produces about \$US700 million of rough gems a year, is expected to last until 2017.

Rio's Diavik mine in Canada will drop "sharply", says Picton. Rio plans to spend \$US910 million to extend the life of its Argyle mine to 2018.

"The really tricky bit with diamond exploration companies is finding a kimberlite that is actually economically viable," says Sacha Borthwick, an analyst at stockbroker Hargreave Hale in London. "The odds of that are very low."

Diamond miners are spending more to find the stones. De Beers plans to invest \$US175 million in opening South Africa's Voorspoed mine, which was closed 97 years ago, and a further 1 billion rand (\$200 million) on a project on the seabed off South Africa's coast. In Canada, De Beers is spending \$US1.8 billion digging the Snap Lake and Victor mines.

"Diamond stocks have underperformed other mining stocks in this commodity bull run," says New York-based James Passin, whose \$US500 million Firebird Global Fund has a 10 per cent holding in diamond stocks. "This is about to change."

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