AS GLOBAL DEMAND FOR DIAMONDS RISES, MARKET PRICES WILL IMPROVE

During recent months, diamond mining stocks have felt like a vortex that takes your money and does not give it back, says diamond market analyst Paul Zimnisky. But things are not as bad as they may seem.

By Paul Zimnisky

For years natural diamonds have been the envy of the luxury industry. The penetration of diamonds is unmatched, it is the one luxury item that most women, in American at least, will be gifted in their lifetime.

A basket of modified-market cap weighed independent diamond miner stocks was down 14 percent in the first quarter of 2019, following a decline of 29 percent in 2018 and a decline of 17 percent in 2017. While apathetic rough diamond prices, and downright weakness in smaller, lower-quality categories, has impacted miner profitability in recent years, investor concern over the threat of lab-grown diamonds has significantly weighed on stock prices.

During Alrosa's Capital Markets Day in March, the company said the one question that it gets asked most frequently during one-on-one meetings with institutional investors is: how much will "synthetic" diamonds impact the diamond mining business? The same week, on a Mountain Province Diamonds analyst call, during the question-and-answer session, a portfolio manager blatantly shared his view that lab grown diamonds (LGDs) will ultimately doom the natural diamond industry, a view that has been shared by other professional investors as well.
Recently diamond mining stocks have felt like a vortex that takes your money and does not give it back, so investor frustration is understandable. However, it starting to feel as if investor sentiment is leaning towards the notion that the independent diamond mining industry will not survive, which seems like an overreaction.

LGDs will inevitably take some market share from natural diamonds, especially at the lower price points, just as moissanite and cubic zirconia did, however the extent is yet to be determined and will most likely depend on the success of marketing by not just the lab-created industry but also the natural industry, which has a very resilient history.

> **Importantly, neither Tiffany nor Chow Tai Fook offer LGDs.**

For years natural diamonds have been the envy of the luxury industry. The penetration of diamonds is unmatched, it is the one luxury item that most women, in American at least, will be gifted in their lifetime. However, maintaining such an overwhelming market position is almost as difficult as building it, especially in the post-De Beers monopoly era in the absence of "A Diamond is Forever" campaign.

While the challenge of maintaining market penetration in the industry's most developed markets is somewhat offset by growth in emerging markets, especially China and India which have the potential to eventually overtake the U.S. market in size, the diamond industry undeniably faces aforementioned confrontation. This said, the natural diamond industry seems far from going away any time soon. Natural diamond supply is estimated to come off some five million carats this year and continue to incrementally decline through at least 2021, which should be supportive of diamond prices and thus the miners. Weaker prices over the last five-plus years have led to a natural paring of supply which is approaching more normalised levels after reaching a post-global-financial-crisis high in 2017. On the demand side, despite various global macro-economic concerns, global demand for natural diamonds appears to be relatively stable. The largest jeweller in the world, Tiffany & Co. recently guided sales increasing at a "low-single-digit percentage" in the 12 months ending January 31, 2020. Further, the largest jeweler in Greater China, Chow Tai Fook, opened a record number of new stores in the most recent fiscal year ended March 31, 2019, an undeniable bid of confidence in the growth potential of that market. Importantly, neither Tiffany nor Chow Tai Fook offer LGDs.

While investor sentiment drives the valuation portion of stock prices, fundamentals such as diamond prices achieved at market and operational effectiveness at the mine level are what ultimately lead to the success or failure of a company. Seemingly stable global demand for natural diamonds and an apparent favorable supply picture should be supportive of diamond prices and the companies producing them, especially those with de-risked mining operations and a manageable debt load.

About Paul Zimnisky
Paul Zimnisky is an independent diamond industry analyst and consultant based in the New York City metro area. He can be contacted at paul@paulzimnisky.com and followed on Twitter @ paulzimnisky. More information can be found at www.paulzimnisky.com.