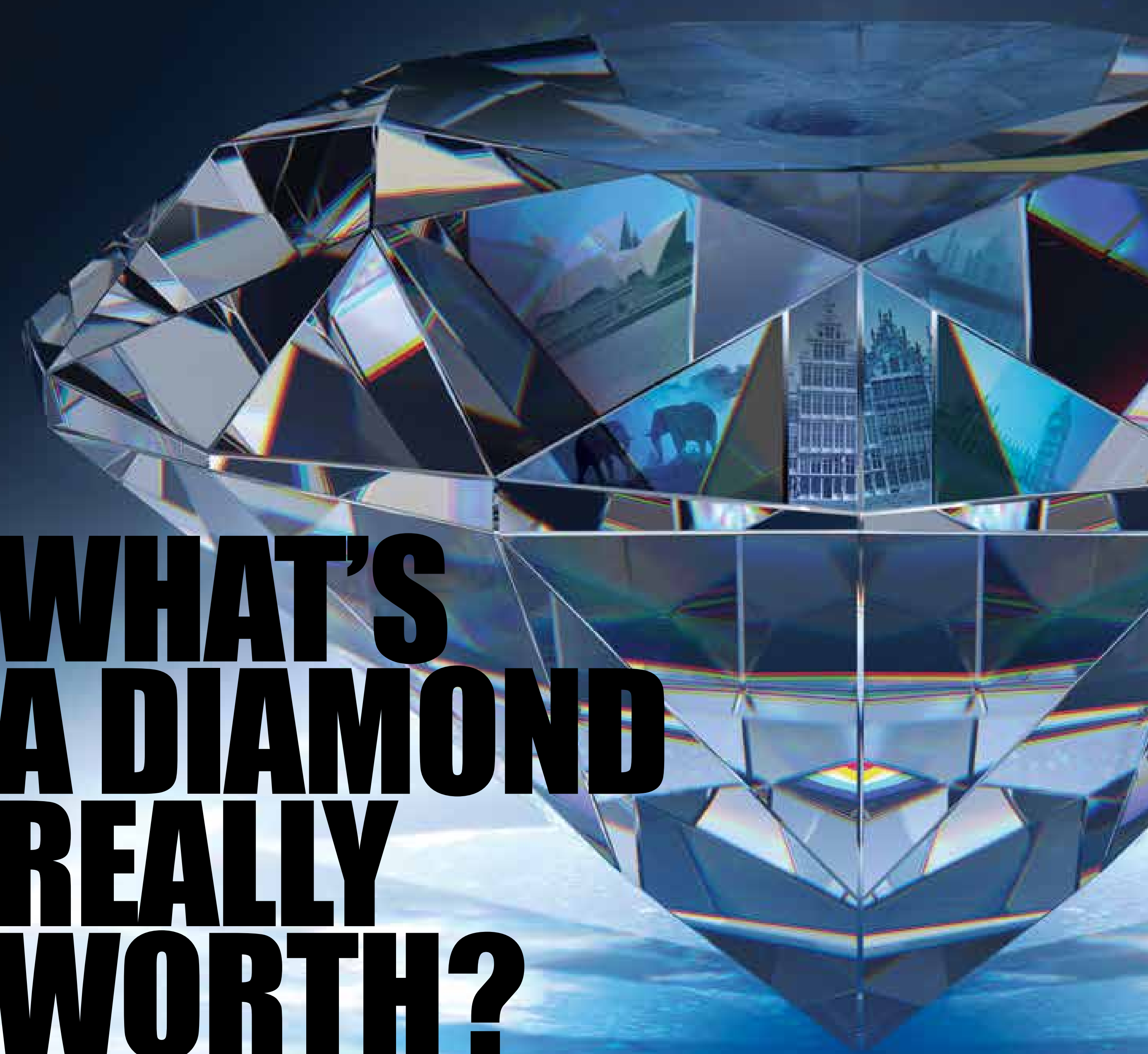


WHAT'S A DIAMOND REALLY WORTH?

The physical, psychological and financial factors that make up the value of the North's key stone

BY HERB MATHISEN

Diamonds might be forever. Diamonds may also be a girl's best friend. But one thing's for sure—figuring out the value of a diamond isn't easy. The stones that come out of the ground bear little resemblance to the diamonds that sparkle on rings or pendants. A diamond will travel across the globe for cutting and polishing—to places as far flung as Belgium and Botswana then India and back—and before it winds up on your finger, it will be sold multiple times, at prices that vary according to market demand at each stage.

Since the private sector economy of the Northwest Territories hinges on the export of rough diamonds, we figured we'd try to bring some clarity to this complex and opaque industry.

The price of commodities generally depends on demand. Bulk metals like copper and iron ore are largely tied to growth in the developing world, as they are the raw construction materials needed to build houses and highways and other infrastructure. Emerging battery or green-energy technologies can create demand for materials like cobalt, lithium and other rare earth elements. And a growing economy means consumers will have more disposable income to spend on pretty much whatever they want.

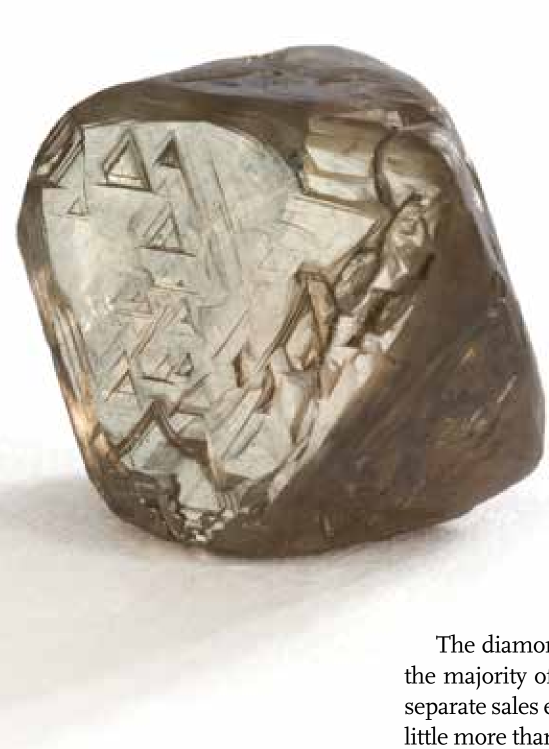
But is that what drives the price of diamonds? Is it strictly straight-up demand from lovebirds buying engagement rings? Does it come down to the quality of each diamond being evaluated? Or does the value all go back to the prolonged and concentrated marketing efforts of a global diamond giant?

It's actually a combination of all of these factors. ↠

First, a little background.

For more than a hundred years, one company dominated the diamond game. That company was De Beers. Going back to the late 1880s, it mined the majority of the world's rough diamonds—the stones that, once cut and polished, are set onto the rings and things you find in display cases at your local jewellery store. As new diamond discoveries were made over the decades, De Beers saw its share of production diminish. Still, it retained a hold on diamond distribution—the sale of rough diamonds. De Beers bought rough diamonds from other miners and sold them to cutters and polishers. By doing this, De Beers essentially controlled how many diamonds would be released into the market each year. This gave it a position of strength when negotiating prices with its clients.

Prior to De Beers, diamonds were a symbol of affluence and they were coveted by royalty for their brilliant physical characteristics and because they were so rare. But as more and more diamonds made it to market in the first half of the 1900s, the perception of rarity was threatened. In response, De Beers sponsored an advertising campaign designed to tie diamonds to love and loyalty through the purchase of an engagement ring—the bigger the stone, the bigger the commitment. And because you cherish your diamond and hang onto it for life, there weren't diamonds for sale on secondary markets, which could have undermined their value. (This campaign produced one of the most successful slogans ever—"a diamond is forever.") By the end of the last century, the diamond engagement ring was a custom that had spread across the globe. The diamond's value in the culture was cemented.



But at the turn of the millennium, new mines in Australia and Canada's Northwest Territories weren't part of De Beers's distribution scheme. At the same time, lawmakers in the U.S. and Europe were beginning to think De Beers owned too much of the diamond distribution pie. Soon, the company's sales model broke apart.

So where does that leave us today?

Right now, De Beers accounts for more than 30 percent of global diamond production. (It is the majority owner of the Gahcho Kué mine in the Northwest Territories.) The biggest producer by volume is Alrosa, a group of diamond mines majority-run by the Russian government. Together, these two companies are responsible for about 70 percent of the world's rough diamonds.

The NWT is home to two other diamond mines—Ekati and Diavik. (Dominion Diamond Corp. owns Ekati and a 40-percent stake in Rio Tinto's Diavik.) And there's a new diamond mine in Northern Quebec: Stornoway's Renard mine opened last year. "The industry is now more fragmented than ever before," says Paul Zimnisky, an independent diamond sector analyst based in New York.

Diamond miners sell their rough diamonds to cutters and polishers. Often, these rough diamonds will be sold to a wholesaler at a trading centre overseas, and then to a cutter and polisher in India or Tel Aviv.

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Paul Zimnisky,
INDEPENDENT DIAMOND SECTOR ANALYST

The diamond giants (De Beers and Alrosa) and other big producers, like Dominion and Rio Tinto, sell the majority of their supply to manufacturers at pre-negotiated prices through long-term contracts at ten separate sales each year. This arrangement works for the manufacturer because, even though they may pay a little more than market value, it means they don't have to travel the world over to smaller auctions to buy all the rough diamonds needed to keep their operations running. "It would be too cumbersome and it would be too expensive," says Zimnisky. "The buyer gets consistent supply and the miner, in return, gets consistent revenue and consistent presence of a buyer."

But not every company goes that route. Newer miners like Stornoway and Mountain Province Diamonds—49-percent owner of De Beers's Gahcho Kué mine—sell their diamonds right now at smaller tenders, where prices more closely reflect the current market. If diamond demand is high at the time, prices at these sales will be higher. If the market is slow, the price will be lower. Even De Beers sells a small percentage of its stock this way, as it allows the company to get a sense of the state of the market. This helps them settle on prices for future contracts.

Market demand determines prices here. For instance, diamond prices recently fell during the recession of 2008 and 2009, but rose again with the economic recovery to record highs in 2011. In the years that followed, manufacturers bought diamonds like crazy in anticipation of an expected boom in China and India, where engagement rings were becoming more popular. But that demand never fully materialized and the manufacturers had an excess stockpile of diamonds on their hands, which meant they didn't need new rough diamonds. This had the effect of lowering the prices miners could fetch for their inventory. (Overall rough diamond production is expected to peak this year with new mines coming online, but drop off by 2020, when some mines are expected to shut down.)

So it's fairly straightforward supply-and-demand economics, right? Well, that's just part of it. Not all diamonds are created equal.

Diamond prices can vary based on the size and quality of the stone. For instance, the average price-per-carat at one mine can be upwards of US$500 while the price-per-carat at another could be US$90. This difference comes down to the natural assortment of diamonds being mined at each operation. And value is based on what's known in the industry as the four Cs—colour, clarity, cut and carat.

A team of sorters separates the mined rough diamonds into different groups based on size, or carat weight. (A carat, in diamond terms, is equivalent to 200 milligrams.) Later, the diamonds will be further sorted by analyzing their shape (which will determine how they can be cut), colour and clarity. Using the four Cs as sorting categories, the rough diamonds can fall within one of roughly 10,000 different price-points. Once grouped together in parcels, the rough diamonds are put up for sale—each group has its own specific clients and associated price fluctuations based on market demand.

Size is a big determinant in diamond price. A ten-carat diamond isn't just worth twice as much as a five-carat diamond—it's worth multiples more, says Zimnisky. "You always kind of hear those skeptics say that diamonds aren't even rare. You just have to be specific with what you're saying because the lower quality stuff isn't that rare, but the higher quality larger stuff is actually very, very rare," he says. "You kind of have to make that distinction."

When Dominion Diamond Corp., say, reports an average per-carat-price of US$90, this refers to the average price it gets from all of its categories of rough diamonds. For example, its February 2017 sales noted a high-value US$280 per carat for diamonds from its Koala deposit and a low-value US$37 per carat from its Misery South Extension. (What makes NWT diamond mines so special is their concentration of carats. Though the average per-carat-price up here might be lower than other mines, the volume of diamonds in the ore—the carats per tonne—is much higher. Think of it as a sandbox: the NWT mines have a bunch of loonies, quarters and dimes littered throughout it, while a high per-carat-price operation will have a

Diamonds CONTINUED

twenty dollar bill and a couple tens and fives hidden in there.)

With colour, clear white diamonds are optimal, based on the way they shimmer and reflect light. Blue and pink diamonds will fetch premium prices too. Some off-colour diamonds with yellow or brown hues are less valuable. But again, marketing can pay dividends. The Argyle mine in Australia has been one of the biggest diamond producers for decades. The majority of its diamonds were tinted yellow or brown. A jewellery manufacturer called Le Vian had an idea to market the brown-tinted stones as something unique. "They trademarked the name Chocolate Diamond and it actually was quite successful," says Zimnisky. Argyle was able to decrease the discount of its brown diamonds.

Zimnisky says there's an opportunity for Northern Canadian mines to raise the value of their diamonds. "When you look at the newer customers—the millennial demographic—they value the story. And a lot of those consumers do want a Canadian diamond and they're willing to pay a premium for it," he says. "You're seeing more and more companies actually sell a story with the diamond versus just a generic diamond."

At the same time, miners know that not everyone goes brand-shopping for diamonds. "When the De Beers monopoly was dismantled, that 'A diamond is forever' campaign that everybody's familiar with, that kind of went its way as well," says Zimnisky. De Beers figured, why help other companies by generically marketing diamonds? Instead, it marketed its own brand—Forevermark. But the entire industry, including De Beers, recently banded together to fund a generic diamond marketing campaign that targets millennials called "Real is rare." The messaging puts lab-created synthetic diamonds, which are becoming cheaper to make, in the crosshairs. But when you consider a synthetic ruby is worth only a fraction of an equivalent natural ruby, it's hazy whether synthetics will be much of a threat.

"Since the beginning of mankind, there's been an allure for natural diamonds and gold," says Zimnisky. "I don't know if that's going to change for now."

Whether that allure is based on the diamond's sparkling brilliance or on generations of conditioning, it doesn't really matter. Just like designer handbags or Air Jordans, as long as people keep buying them, a diamond will have value forever. And that's good news for the Northwest Territories.