

## Crisis Mitigation at De Beers

By: Chaim Even-Zohar

At the same time that governments and central banks were pouring trillions of dollars into the world's financial markets to save them, De Beers pooled all of its resources in preparation for launching the single-greatest consumer advertising blitz in the history of the company. It isn't just throwing good money away. Though De Beers has no illusions and realizes that consumer spending will be down this season, it recognizes a real opportunity to increase the share spent on diamonds out of the total consumer expenditure.

Just as it did in the aftermath of the 9/11 tragedy (David Lamb, Forevermark Chief Strategic Officer doesn't like that analogy as this isn't a human tragedy), De Beers has retuned its message to show why diamonds matter, particularly in troubled times. The message was crafted based on the findings of two leading consumer-attitude research consultancies, TNS and Sonar, which De Beers commissioned to gauge the mood among U.S. consumers.

Upon seeing some of the findings of these independent surveys, the first thought that crossed my mind was: "Wow! If there had been no financial crisis, De Beers should have created one!" The value-conscious and cash-tight consumers seem to prefer, by great margins, diamond purchases over any other gift. This firmly positions diamond jewelry as the number one holiday gift for the upcoming 2008 holiday season.

TNS found, for example, that when affluent married people (in the 25-54 age bracket; annual income +\$100,000) were asked to choose one single item from a range of 12 competing gifts, 25 percent chose diamonds. The closest competitor was electronic goods (e.g. flat screen TVs) at 11 percent. Thus diamonds, as a holiday gift, are more than twice as popular as any other possible holiday gift choice. But the most telling research finding was that 62 percent of women said they would rather receive "one gift of better quality at Christmas than several smaller gifts."

No one has cancelled the holidays in the United States or in the rest of the world. People will celebrate; presents will be exchanged. The research indicated that, if anything, the economic crisis has reinforced and enhanced the "enduring value" aspect of diamonds in the eye of the consumers. About 66 percent of women agreed that "it is wonderful to hand jewelry down to the next generation." Among the affluent buyers, price is not the issue.

In my briefings at De Beers in London, the "R"-word didn't come up. But it became clear that the only thing that might obliterate any chance for a reasonable Christmas season is the message that all polished prices are on a downward roller coaster - especially when it isn't so. It is difficult to reconcile the sentiment, based on solid research, that the consumer "considers diamonds a safer store of value than many other things" with the message of "I am pulling down the prices of diamonds so don't be in a hurry to buy anything that you can buy cheaper a few years down the road."

Destroying confidence and image is much easier than building them. It also goes much faster and is cheaper. De Beers will, in the next few weeks, promote the diamond value message through 128 full pages advertising in the U.S. most influential national and local newspapers such as the New York Times, Wall Street Journal, Chicago Tribune, Los Angeles Times and San Francisco Chronicle. It will have 22 full-page color insertions in prestigious weeklies such as Business Week, Time, The Economist, Forbes, Fortune, Newsweek and The New Yorker.

De Beers managing director Gareth Penny says that "the diamond value message will reach some 97 million core consumers at least six times between now and Christmas." That figure doesn't include some 40 million media impressions delivered through De Beers online partners such as WallStreetJournal.com and BBC.com.

The company's planned media blitz has a number of clear objectives: (1) to increase the diamond product's share versus other discretionary purchases; (2) to protect the standing (and image) of diamonds among the upper middle class/high-end consumers, which, in the years ahead, will remain the engines of future growth; and (3) to sustain the consumer's "engagement" (i.e., her "fascination") with diamonds even through physical postponement of the purchase itself. For example, let her buy a diamond later, but don't let her spend money now on expensive dresses that will be out of fashion within three months.

The key question is: will it work? The pessimistic mood in the industry isn't greatly conducive to support positive image messages. De Beers has no clear view of what it expects will happen - and if the company knows, it isn't saying. Personally, I believe that we should be prepared to see a 10 percent-15 percent decline in global diamond jewelry sales as compared to the same season last year. However, declining sales don't necessarily have to mean lower prices. Purchases will come mainly from affluent circles which appreciate value. The current economic malaise is still mainly a liquidity problem. Though deflationary pressures are looming in various parts of the economy, there is no evidence that they have hit diamond jewelry purchases.

By and large, diamond purchases are not "impulse" buying; people plan, people save, people prepare themselves for their next purchase occasion. A few questions in the TSN survey focused on future behavior. Some 80 percent of consumers planning to buy diamonds in next 12 months say "current conditions will disrupt neither their plans nor their price tag." That sounds very encouraging, even though the answer also shows that some 20 percent of those intending to purchase may have a second choice.

## De Beers to Decrease Mining Output

De Beers seems to be actively preparing for a decrease in production and a reduction in the sales levels of rough throughout the next year in line with demand from its clients. I double-checked and no undertaking has been made to the antitrust authorities in Europe, which would constrain De Beers in stockpiling their output. Gareth doesn't like the word "stockpiling," and certainly the business model that De Beers has today is one of minimizing inventory and optimizing sales.

In the last few years, at any given time, De Beers has consistently held less than six months of supply, averaging actually around three months. But as DTC managing director Varda Shine explains, the stocks the company has are continuously being worked on in the sorting process. Therefore, when one talks about sorted stock, De Beers has very little.

From a mining perspective, the expected reduction in sales affords the mines to concentrate on activities that are necessary for the long-term sustainability of the mines, which in many instances, are well overdue. Such activities include waste stripping, plant maintenance, truck maintenance, etc. The industry may not be aware of the fact that in recent years, the lack of availability of truck tires has greatly impacted mining activity. These are among the issues that De Beers' mines will be dealing with in the coming year. Each of its mines has a 10-year production plan, and each of the managers are now preparing a revised plan that will be approved and announced around February of next year.

As such, nobody at De Beers today has a clear figure about next year's production. "However," says Gareth, "in the last 10 years, we've gone up from some 30 million carats to some 50 million carats a year, and our focus on optimizing output has come at the expense of other activities, which are now being dealt with."

The planned reduction in mining will inevitably impact the DTC's ability to supply its sightholders. In a presentation to sightholders at the current sight, Varda said, "We are considering ways in which consistent purchasing performance can be factored into next year's Intention To Offer (ITO)." She then added, "We encourage clients to demonstrate leadership behavior." Whatever that means.

Varda's words didn't fail to have an impact. She says that De Beers wants its clients to buy goods to which they can add value; clients should not buy those articles which they can't handle or for which they have no clients. If certain articles are left on the table, says Varda, it only makes good commercial sense that De Beers offer those goods to others who can add value to them. It also makes good commercial sense that next year, when the DTC considers the next ITOs, it carefully looks at who was able to add value and who wasn't.

Last night, I asked Varda how many sightholders had left goods on the table this week. Her answer was evasive. "Chaim, we are still in the middle of the sight, and because of Diwali, many of the Indian customers are only coming at the end of the sight week. People don't make decisions right at the moment, but yes, there are some people who are not taking all that is being offered."

Regarding rough prices, Gareth told me, and I assume he also says this to clients, that De Beers, in a bull market, never charges the highest prices in the market and that the same is true in a bear market, that De Beers would never charge the lowest prices in the market. "I'm convinced," says Gareth, "that we are competing in providing the best value proposition to clients in the form of long-term best assortments and consistency of supply, etc. Our rough prices are set based on the price of the resulting polished. We call it RTOP. Rough to Polished. That has been our policy and it will continue to be our policy."

I think the message De Beers is giving is a clear one: Yes, there are consequences for leaving goods on the table, and no they are not going to lead in reducing prices. At the same time, De Beers is reiterating that it is "fully prepared to reduce production in line with changes in demand." The bottom line is that if, on a macro level, the supply-and-demand equilibrium in rough is maintained, the impact on prices should be minimal.

As I pointed out before, rough prices still need a technical correction because they are out of sync with resultant polished. DTC sightholders looking at the goods this week believe that they see an improvement in the assortment, which would have the actual impact of a softening of prices in the four percent to six percent range. There also seems to be a consensus that the rough price is still significantly too high.

### Sticking to Proven Methods

With due respect for all the great changes we have seen in this decade, the so-called post-cartel period removed from a supply-controlled system to a demand-driven one, in times of crisis, the old proven methods still seem to prevail, although in a more elegant and more customer-friendly manner. De Beers and Alrosa keep stressing the virtues of showing loyalty and continued support to the producer in adverse times. If, 20 years ago, you might have been dropped for refusing a sight, now the system is more amenable to listen to good explanations and to taking all circumstances into account. There are also other obligations, and I can't see De Beers refusing its sights to manufacturers in beneficiation countries given the commitments to governments there.

At the same time, De Beers is certainly supporting industry by initiating this unprecedented promotion campaign, which is something that is not being done by any other producer on such a large scale as this. With all the talk about joint efforts in generic diamond promotions, which was also the subject of the St. Petersburg conclave that took place in Russia in September, nothing concrete has come out from all these deliberations.

The last two DTC sights of the year are small, very small, in any case. What happens in the consumer markets in the next six weeks is far more crucial than any discussions on supply, demand, rough prices, etc. Actually, many of these issues depend on what does happen in the next six weeks. We would all be well advised to concentrate on how to break the present stalemate in the market, where hardly any trading takes place because of fear that payments will not be forthcoming. It is still mostly a financial crisis.

Whatever happens within the trade, to quote Varda, "people still get married and celebrate important anniversaries - recession or not. Business will still be done, Christmas gifts will still be purchased." That being said, consumers must be confident that what they buy holds value.

The industry is facing a crisis and De Beers seems to be living up to the challenge. With all the reservations I may have for many of De Beers' policies, when the company deserves to be saluted, I do so. And after having seen the details of what's in store with its upcoming marketing blitz, I salute the company wholeheartedly. It will soften the pain for all.