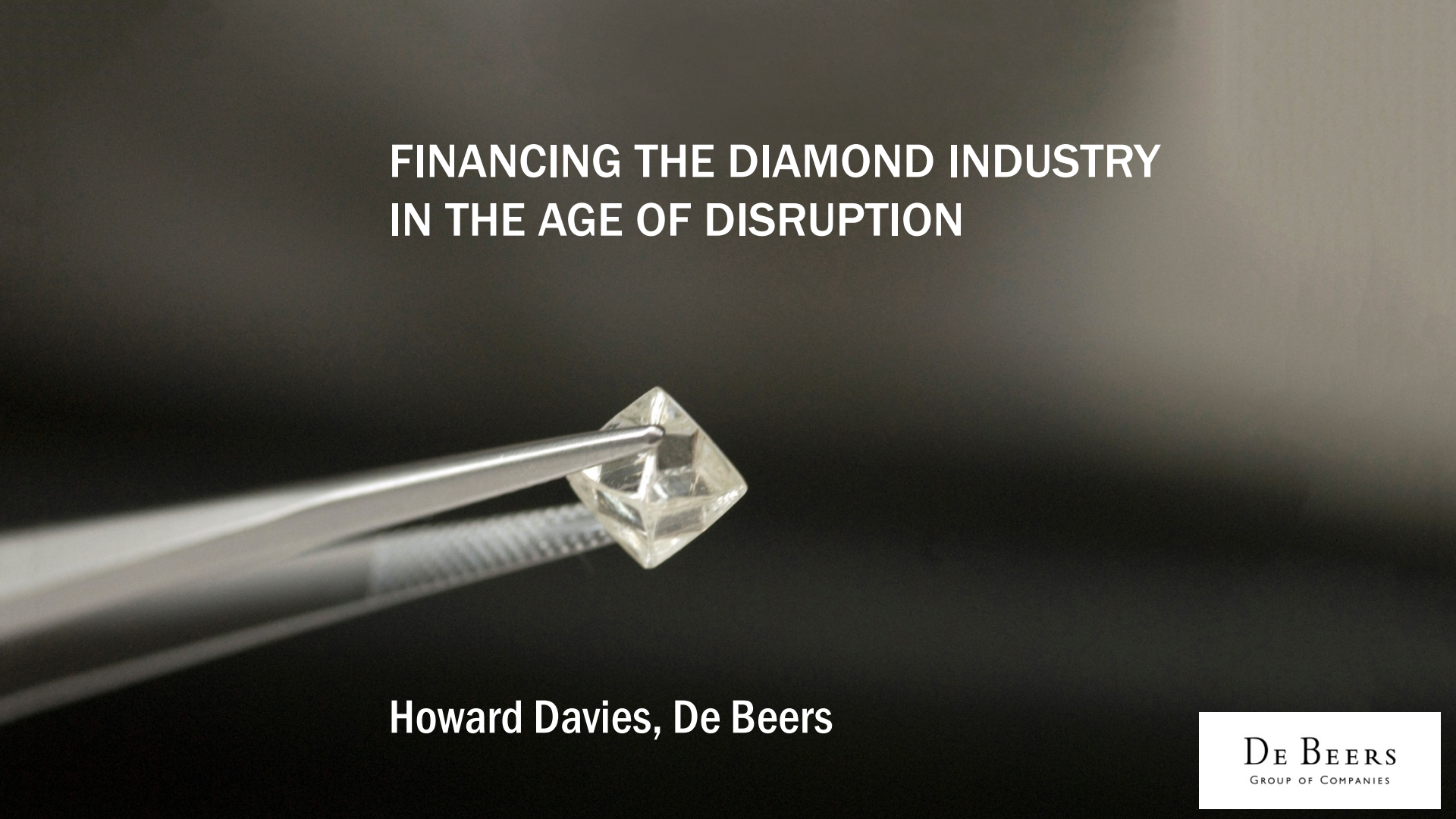
# FINANCING THE DIAMOND INDUSTRY IN THE AGE OF DISRUPTION



Howard Davies, De Beers

De Beers
Group of Companies

# A TRADITIONAL INDUSTRY

# A CAPITAL INTENSIVE BUSINESS

| Business cycle | Cash cycle | Source of funds |
|---|---|---|
| Purchase and processing of raw materials | 30-90 days+, depending on complexity of processing | Short-term working capital finance from banks funds the majority of rough purchases and work-in-progress. |
| Finished goods in stock | Average 60 days+ | Mainly funded from owners' own equity, and by banks funding 'in-house' receivables. |
| Goods sold, typically on credit | 30-120 days+, dependent on size & quality of goods | Short-term working capital finance from banks funds the majority of receivables. Limited use of receivables securitisations. |

Average is 200 -300 days, but with much variation

# THE BANKS' FUNDING CYCLE

## Rough purchase funding

1

Bank fund the purchase of rough diamonds typically on 30-90 days credit terms

## Polished receivables funding

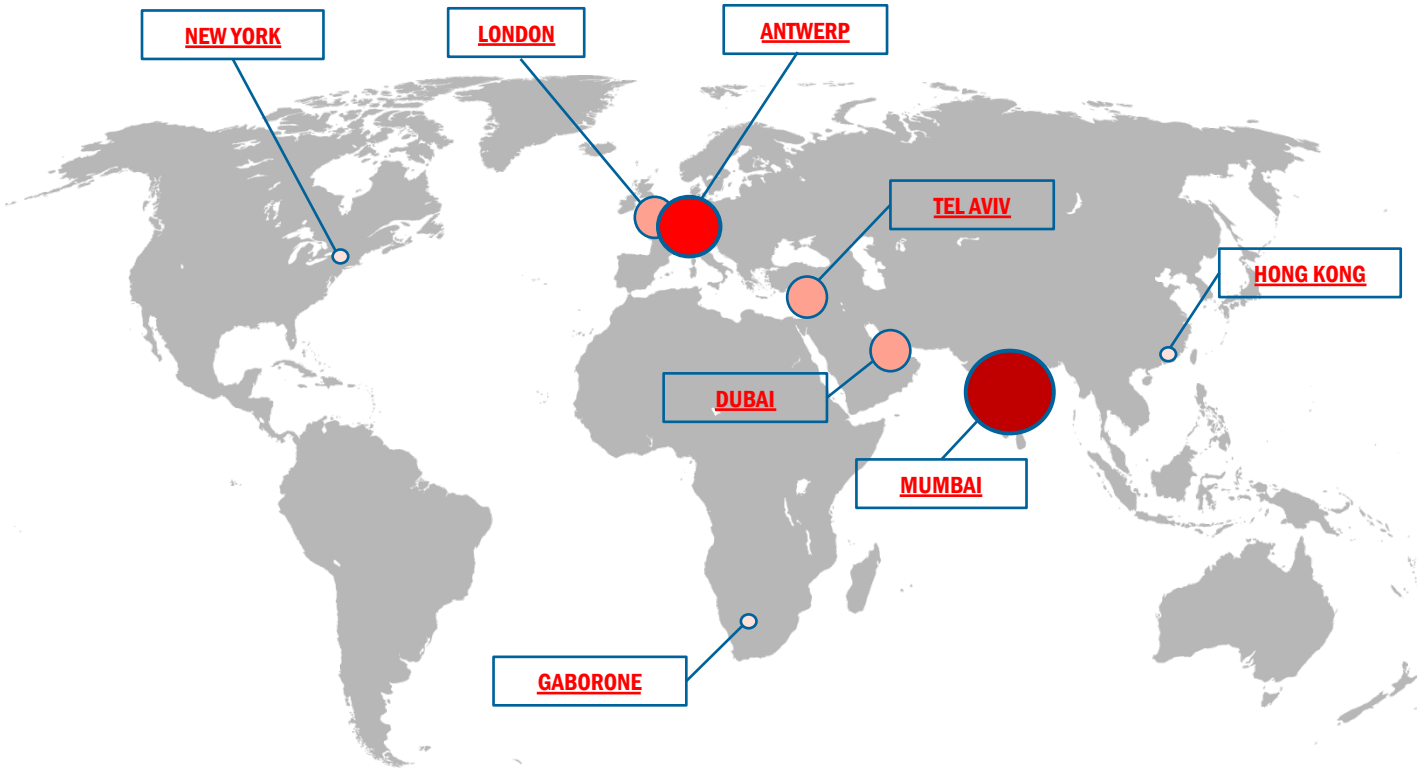
2

Purchase credit can 'convert' into receivables credit to fund polished sold downstream on 30-120 day credit terms

**Banks view both Rough purchases and Polished receivables as self-liquidating assets.**

# MIDSTREAM BANK CREDIT:

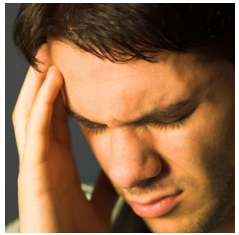
***A GLOBAL NETWORK OF BANKS PROVIDES AROUND $16BN OF CREDIT LINES TO THE MIDSTREAM, OF WHICH AROUND 68% ($11BN) IS CURRENTLY UTILISED***



# BANKERS' HEADACHES

INDUSTRY RISK PROFILE

TRANSPARENCY ISSUES



LOW PROFITABILITY

BAD DEBTS

BASEL REGULATIONS

COMPLIANCE OVERHEADS

# PRIMARY PRODUCERS ARE NOW DEMANDING HIGHER COMPLIANCE STANDARDS FROM THEIR CUSTOMERS

## CASE STUDY: Requirements for a De Beers supply contract:

- Evidence of an IFRS-compliant **corporate structure** for the Sightholder Group
- An **annual consolidated financial statement** for the entire Sightholder Group, expressed to IFRS or equivalent (e.g. US GAAP)
- An **audit signoff** on the annual financial statement
- **Prior approval** from De Beers of the Sightholder Group's auditor
- Audit opinion must be **unqualified** – in particular, as to inventory value
- A maximum **debt equity ratio** of 70:30
- Annual re-assessment

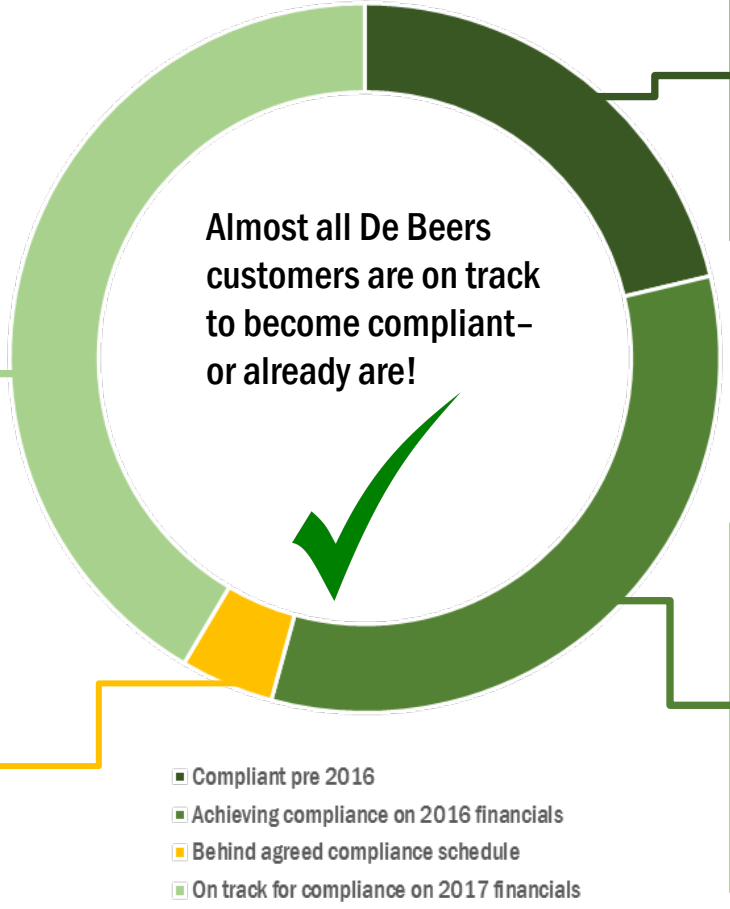
# DEMANDING THE IMPOSSIBLE?

“Revolution consists of reasonable people making reasonable demands that, within the current ideology, are impossible.” **SLAVOJ ZIZEK**

# FINANCIAL COMPLIANCE: CURRENT STATUS

**Early Adopters: Compliant pre 2016**
- Clear corporate structures
- Strong, clear equity base
- Well-established internal management systems and controls
- Familiar with audit process

**On track for 2017**
- New corporate structures being finalised
- New internal systems still bedding in
- Constructive dialogue with audit partners
- Equity issues resolved
- Monthly dialogue while the transition completes




**Recent achievers: Compliant in 2016**
- Corporate structures now clarified
- Overhaul of internal systems now completed
- Constructive dialogue with audit partners
- Restructured equity base

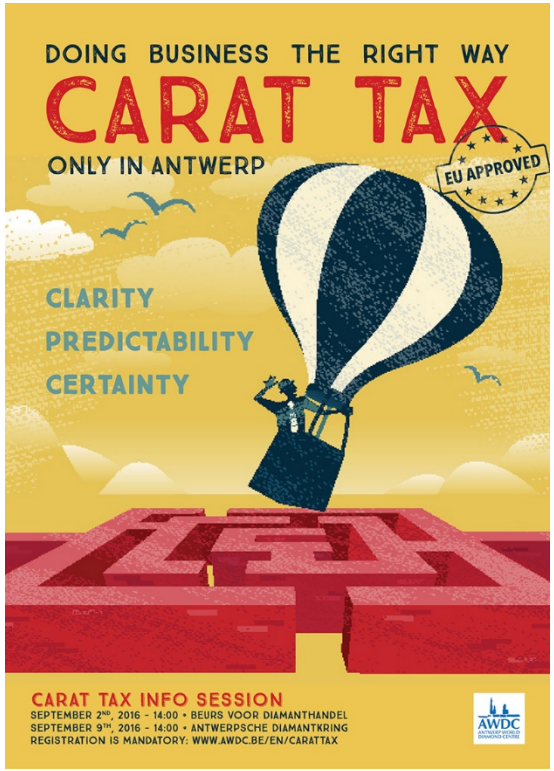
**Question marks**
- Uncertainty over D/E compliance
- Audit qualification may be unavoidable
- Remedial plans in place, with escalating remedies for non-resolution.

# IN A NEW WORLD OF TRANSPARENCY…

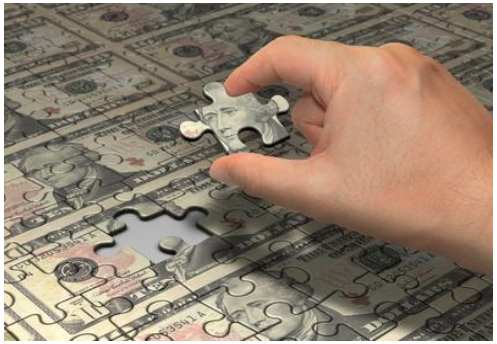
Goods & Services Tax

THE ISRAEL DIAMOND EXCHANGE LTD.
בורסת היהלומים הישראלית בע"מ

BLOCKCHAIN



# ..LONGER TERM FUNDING INSTRUMENTS ARE EMERGING, BUT ONLY FOR THE LARGER AND MORE PROGRESSIVE DIAMANTAIRES



# CONCLUSIONS:
# EMERGING TRENDS IN MIDSTREAM FINANCE

- Some short term funding will exit between now and 2020
- This may cause medium term volatility
- New banks will take exposure to high-quality midstream assets
- Longer-term funding instruments will increase
- Large diamond businesses will build funding portfolios
- Smaller businesses will depend more on their own equity, or will exit the industry
- Technology will make transparency non-negotiable

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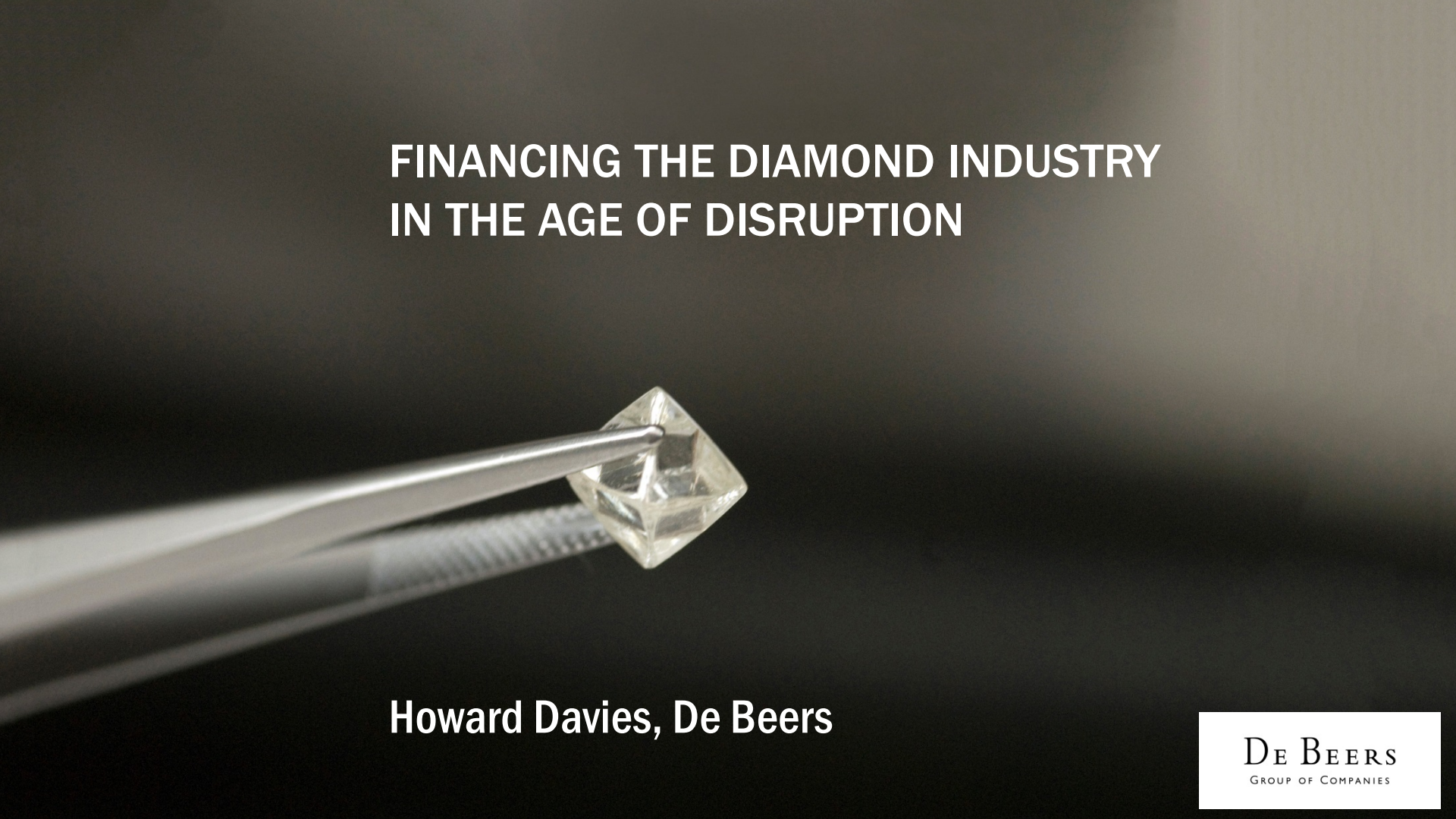

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