FINANCING THE DIAMOND INDUSTRY IN THE AGE OF DISRUPTION

Howard Davies, De Beers
A TRADITIONAL INDUSTRY
## A CAPITAL INTENSIVE BUSINESS

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

Average is 200-300 days, but with much variation
The De Beers Group of Companies

THE BANKS’ FUNDING CYCLE

Rough purchase funding

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

Polished receivables funding

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
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

PRIMARY PRODUCERS ARE NOW DEMANDING HIGHER COMPLIANCE STANDARDS FROM THEIR CUSTOMERS
DEMANDING THE IMPOSSIBLE?

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

SLAVOJ ZIZEK
FINANCIAL COMPLIANCE: CURRENT STATUS

**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

**Almost all De Beers customers are on track to become compliant – or already are!**

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

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

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

- Compliant pre 2016
- Achieving compliance on 2016 financials
- Behind agreed compliance schedule
- On track for compliance on 2017 financials
IN A NEW WORLD OF TRANSPARENCY...
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