

CLM Heard on the Street
HD **U.S. Recovery Helps Diamonds Look Rock-Hard**

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All that glitters is not **gold**. Rough diamond prices have risen by 5% to 10% this year, according to analysts. Investors now also have more options to bet on the stones.

Diamonds are a rare commodity in more ways than one: with a dearth of new discoveries since the 1990s, supply of rough stones remains below the precrisis peak of 2005 and is set to start falling from 2018, forecasts Bain & **Company**.

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Meanwhile, demand growth looks strong, at over 5% annually from 2012 to 2023, according to Bain. Growth in the emerging world is part of the story, as middle-class wealth expands in markets like **China** and more brides-to-be receive a diamond engagement ring.

Economic recovery in the U.S., still the world's largest market for sales of polished diamonds, provides another boost. The U.S. market grew 7% last year by value, according to De Beers; older, more affluent brides on average are sporting larger, more expensive stones.

So rough diamonds could be in short supply from 2016 or 2017. But investors seeking a pure-play bet on a tight market have had limited options. The largest diamond miner globally by sales, De Beers, is owned by diversified miner Anglo American; the diamond **operations** at Rio Tinto are dwarfed by its **iron-ore** side. Russia's Alrosa brings its own idiosyncratic risks.

A crop of much smaller, independent diamond miners, therefore, have been attracting attention. Shares in Gem Diamonds, Petra Diamonds and Toronto-listed Lucara Diamond are up between 40% and 50% this year. In part that is because, after years of investment, these companies are coming of age: Lucara this year announced its maiden dividend; Gem plans its first payout at the end of 2014.

Petra is further behind: it could pay a dividend for its fiscal year to June 2016. But the **company**, which was built around mines sold by De Beers, is arguably more diversified than peers with five producing mines, four in South Africa.

It also promises growth: Petra aims to increase production from 3.1 **million** carats in its 2014 fiscal year to June to 5 **million** carats by 2019. Buoyant diamond prices allied with falling capital spending should translate into substantial growth in free cash flows. **Mining** new, richer areas will also boost margins.

The **company** is facing a tricky year operationally: it must live off **mining** old, low-grade areas before expansion starts up. Petra this month downgraded its production guidance for 2015 but still hopes to eke out some growth.

That, plus a recent **sale** by a large shareholder, has weighed on the stock: it is back to levels last seen in June when Petra said it had found a 122.5 carat blue diamond, expected to fetch some \$30 **million**. Petra is trading at about 0.7 to 0.9 times most analysts' forecast net present value of its cash flows. Junior miners trade between about 0.5 times to 1.3 times NPV through the cycle, according to BMO Capital Markets.

The diamond miner may face a tough year, but Petra still has potential to shine.

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CO aamcr : Anglo American PLC | alnyrb : Alrosa-Nyurba OAO | bainc : Bain & Company, Inc. | gemdib : Gem Diamonds Ltd | tellg : Lucara Diamond Corp | almrs : Alrosa Co Ltd

IN igems : Gemstone Mining | ibssv : Business Support Services | imet : Mining/Quarrying | i22472 : Precious Metals | ibcs : Business/Consumer Services | ibasicm : Basic Materials/Resources | i22 : Primary Metals | i224 : Non-ferrous Metals | i231 : Non-metallic Mineral Mining/Quarrying | i83951 : Management Consulting | iacc : Accounting/Consulting | icnsl : Business Consultancy

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