

Earnings Call Transcript

Rockwell Diamonds Inc. Fiscal 2008 Earnings Call

EVENT DATE/TIME: MAY 28, 2008 / 10:00AM ET

CORPORATE PARTICIPANTS

Susie Bell – Investor Relations

John Bristow – President & CEO

Dominique de la Roche - CFO

Jeffrey Brenner – Manager, Diamond Marketing and Sales

Note: All dollar figures are expressed in C\$ unless otherwise stated.

Operator

Good day, ladies and gentlemen, and welcome to today's Rockwell Diamonds' Fiscal 2008 Earnings conference call. At this time, all participants are in a listen-only mode and we will conduct a question-and-answer session at the end of the conference call. As a reminder, today's call is being recorded.

At this time, I'd like to turn the call over to your host, Ms. Susie Bell, Investor Relations. Please go ahead.

Susie Bell – Rockwell Diamonds – Investor Relations

Thank you, Trisha, and good day and welcome to Rockwell Diamonds' Fiscal 2008 Earnings conference call. My name is Susie Bell, and I'm in Investor Relations for Rockwell Diamonds. With me today on the call are John Bristow, President and CEO of Rockwell, Dominique de la Roche, CFO and Director for Rockwell, as well as Jeffrey Brenner, Manager, Diamond Marketing and Sales. After the opening remarks by management, we will review the fiscal 2008 business and operational results. We will open the phone lines to analysts and investors for a question-and-answer session.

I would also like to remind our listeners that our comments and answers to your questions may contain forward-looking information. This information by its nature is subject to risks and uncertainties and may cause a stated outcome to differ materially from the actual outcome. Please refer to the bottom of our latest news release for more information. I will turn the call over to John for his remarks.

John Bristow – Rockwell Diamonds – President & CEO

Thank you, Susie, and good morning or evening, ladies and gentlemen. Many thanks for making time to join in our maiden Rockwell earnings call which covers results for our 2008 financial year which ended on the 29th of February of this year. I will proceed with a brief overview of the results and progress that we have made in the company, and I will be followed by our CFO, and after that, as Susie noted, we will take questions and answer them.

To kick off, I would like to point out that we changed our year-end recently, and so the results we have presented for Rockwell today are for a nine-month period and, hence, not an ideal reflection of the company's activities. Equally, year-on-year comparisons are made difficult by the fact that we only started up in late 2006 and our financial year 2007 results reflected four months of operating earnings and 12 months of head office cost. So, year-on-year financial comparisons are also difficult.

Equally, during fiscal 2008, Rockwell only held 51% of the underlying operating entities, with the balance of 49% held by a non-controlling shareholder. This has a direct impact on the financial figures presented in our year-end results. As of 1 March, 2008, ownership has increased to 74% in Rockwell's hands and non-controlling interest has decreased to 26%. Having noted those points, let me move on.

The company generated revenue of \$36.1 million for financial year 2008 and a profit of \$6.9 million in the underlying operations, which mined diamonds in the Northern Cape during fiscal 2008. This profit was helped by excellent diamond prices which averaged US\$1,984 – \$1,984 per carat for the nine-month period. This is exceptional by world standards. Rockwell's consolidated cash flow generated by operations was also a healthy \$6.7 million for the 2008 fiscal year.

Clouding the strong profits at the operations and healthy consolidated cash flow from operating activities at the Rockwell level is obviously the total comprehensive loss reflected in the consolidated statements which we show at about \$9 million. We should, however, bear in mind that this is effectively an accounting loss driven largely by the non-controlling interest of 49% and non-cash items such as option values of about \$1.8 million and deferred tax of \$2.5 million. I do not intend to dwell on this, but our CFO, Dominique de la Roche, will explain briefly this aspect when I've finished, and we are quite happy to answer questions on this accounting detail later.

Looking at our mining cash costs, which are an important component of our business over the period, we did see an increase above our target range of \$3 to \$3 and a half per tonne, and we reported \$4.66 in quarter three. Overall for the period, the cash mining costs have averaged out at \$4.32 per tonne with Makoensklouf bulk sampling exercise contributing \$0.50 per tonne of this. If we remove this bulk sampling exercised from the cash costs, the mining cost for the year is at about \$3.82.

There has been a strong increase in things like steel prices and fuels over this period that have impacted negatively on our costs. These two items make up almost 35% of the cash mining cost per ton. For Q1 of the 2009 fiscal year, the year that we are now in, the cash mining cost is heading down and we anticipate it to be in the region of \$3.40 for the period.

One of our key objectives is to be a low-cost alluvial diamond miner and ensure that we can successfully operate the diamond deposits that other companies cannot mine successfully. Obviously maintaining low-cost operating cost is challenging in current conditions of rampant fuel prices and when a company is equally in growth mode and evaluating and developing new projects and not achieving the benefits of mining-based economies of scale.

During fiscal 2008, we did major plant expansions and modernization at Klipdam, we evaluated on-mine resources and conducted developmental work that has undertaken on the company's operations, all of which added to the higher costs.

Going forward, these situations will diminish, and hence, the operating costs are trending down to the target level. The company is fully committed to ensuring that its operating costs are kept in the target range. And consequently, we are managing these in a robust and proactive manner. During calendar 2008, we have devoted considerable effort to ensuring that our Syspro financial management system is fully functional and we are optimizing our earth-moving fleet to reduce diesel and other related costs. The Company, I'm pleased to say, is already seeing the benefits of both of these programs.

Power outages are obviously a concern in a local South African operating context. We have purchased backup generator sets for our four main operations. These are currently in Johannesburg and will be installed on the operations early next month. Assuming we run these generator sets on an 80/20 split – meaning 80% power generation from our utility provider, Eskom, and 20% from the generator sets, we would add about 12% to our cash operating costs. Fortunately for us, although electrical power is important for our operations, it's only about 3% of our total costs.

Moving onto our growth strategy, we are encouraged by the progress we have made since start-up in 2006 and this is reflected by the fact that if we look, for example, at the balance sheet, we show property, plant, and equipment having increased from about \$45 million to \$65 million year-on-year.

Equally encouraging and important is that our resource base has grown substantially by about 826% from 23 million tonnes in 2006 to 190 million tonnes since we have acquired the Saxendrift operations. We will be reporting on this in the near future and expect our diamond-bearing resources to grow further as we proceed with our exploration programs.

Added to the overall growth in resources is that we see very good reconciliation between our predicted and actual grade of the deposits we are mining and this makes it much easier to do sensible mine planning and forward projection.

The sale and beneficiation of our unique product is an area we have made good progress with in fiscal 2008. Though the company continues to sell a large part of its production via successful tender system, we are actively diversifying our sales methods and pursuing beneficiation models which will add further value to Rockwell's unique high-value diamond production.

In this respect, we already have a special agreement with Steinmetz Diamond Group to beneficiate and sell Rockwell products, and I am pleased to report that we now have a steady stream of high-quality stones moving through this pipeline and are seeing excellent additional margins on the rough stone prices that we achieve on these stones. I won't add to this and we'll leave it to Jeffrey Brenner, Manager, Diamond Marketing and Sales, to add later in our discussion.

Finally, we remain fully committed to expanding the company by organic growth and acquisitions. We completed the Saxendrift acquisition in early April, which was frustratingly behind schedule. However, we have made good progress in catching up some of the lost time. We have already recommissioned two small plants on the mine and are producing diamonds at Saxendrift and we are on target with the construction of our new high-volume plants at this mine.

We have also identified a number of other opportunities and these I should stress are opportunities outside the existing mines, operations, and new projects we have which we are evaluating. Some of the evaluation work is quite well progressed, and if some of these transactions are concluded, we see them adding exciting growth and accretive value to the company.

With that brief summary, I would like to thank you and ask Dominique de la Roche to comment briefly on the loss and non-controlling shareholder facets of the business, and in particular that's aimed around the \$9 million loss that we reported in our financials. Thank you.

Dominique de la Roche – Rockwell Diamonds – CFO

Thank you, John. Good afternoon, ladies and gentlemen. If one looks at the income statement, the Company showed a comprehensive loss of \$9.4 million. What one needs to keep in mind is that this is not a cash flow loss, but rather an accounting loss resulting from compliance with certain accounting standards.

If we take a step back and look at the cash flow statement which shows the actual cash position, the Company looks in a much better position, generating \$6.8 million from operating activities. Going back again to the accounting loss, this is primarily as a result of non-cash flow items being booked to the income statement, such as reclamation obligation, stock-based compensation, future income taxes, and non-controlling interest.

Some of these items are potential future cash outflows, but if carefully managed by the company might not materialize. The non-controlling interest is effectively the holding at the operating subsidiaries and the share in the net income at the level at the subsidiaries and not the group level. Due to the subsidiaries being housed in South Africa and Rand denominated, they also have unrealized exchange gains that originate when translation takes place from Rand to Canadian dollars. This is a result of the depreciation of the Rand against the Canadian dollar which we have seen over the last nine-month period.

At the operating subsidiary, there was a total exchange gain of \$9.1 million in which the non-controlling interest shareholders shared 49%. So, the real profit share on the non-controlling interest should have only been \$1.5 million had there not been an exchange gain. At the holding company at South Africa, there was an exchange loss of \$11 million, but due to the fact that non-controlling shareholders are at the operating subsidiaries and not at the holding company level, they did not share in the exchange loss, hence the mismatch that we see.

Had the non-controlling interest been held at the consolidated level, the comprehensive loss would have only been \$1.8 million versus the current \$9.4 million. Other results of RDI increasing its shareholding in the underlying assets: from the 1st of March, 2008, from the current 51% to the 74% in Q1, we will be seeing a reversal back to the income statement of the non-controlling interest. Thanks, John.

John Bristow – Rockwell Diamonds – President & CEO

Thanks very much and thanks to everyone who made the time to engage us. We really appreciate the fact that you took that time. It's a new process for Rockwell and we look forward to the next presentation like this and hopefully we'll have lots of good numbers to present to you at that time. So, thanks to everyone. Enjoy your day or enjoy your evening if you aren't in South Africa or Europe. Thank you.