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Rockwell snubs Pala bid

PRIVATE EQUITY FIRM HOLDS 20% OF DIAMOND MINER



BY GWEN PRESTON

One week's production from Rockwell Diamonds' Holpan project, 45 km from Kimberley, South Africa. The company has reduced its operating costs at the project to US\$3.01 per tonne, from an average of US\$3.20 per tonne.

BY GWEN PRESTON

VANCOUVER — South African alluvial producer **Rockwell Diamonds** (RDI-T, RDIAF-O) is fighting off a hostile takeover offer from its largest shareholder, a private equity firm based in the Channel Islands called Pala Investments.

Pala, which holds just under 20% of Rockwell's outstanding shares, first tabled a friendly bid for the Hunter Dickinson Group company in late August, offering 40¢ per share. When Rockwell failed to respond by the time that bid expired just a week later, Pala handed over a hostile bid at 36¢ per share.

The bid values Rockwell at \$85.7 mil-

lion and represents an 85% premium to Rockwell's share price on Sept. 9. While that may seem generous, Rockwell president and CEO John Bristow doesn't see it that way.

"We consider the Pala bid to be opportunistically timed, inadequately valued, and contrary to the best interests of the majority of this company's shareholders," said Bristow in a conference call. "The overriding problem with this offer is, of course, that Pala wants to pay less than the company is worth. On top of that, they've added a number of conditions that protect their position but no one else's. And they have attempted to transfer most

of the risk involved in their hostile bid to their fellow shareholders."

The question of valuation requires two assessments. The first perspective need come from the company's share price. At the time of Pala's offer, Rockwell was trading at 20¢. However, a year ago, it had peaked at around 70¢ and as recently as June traded at 60¢, before sliding down along with the rest of the markets. So whether the bid offers a premium is a matter of timing.

The second perspective requires a look at Rockwell's assets. The company owns four alluvial diamond operations in South Africa. The grade within its

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mineral holdings, which comprise gravel beds left behind by old rivers, averages less than 1 carat per 100 tonnes. However, the diamonds that are recovered from the riverbeds are high-value — large and of good clarity. Since March 2006, Rockwell's diamond tenders have attained an average price of better than US\$1,700 per carat; this year, its average price climbed to US\$1,881 per carat.

In September, the company announced its latest big find: a 189.6-carat D-colour diamond from the Klipdam operation. In the same month at Klipdam, Rockwell also recovered a small but rare gem: a 1.13-carat intense blue flawless diamond. A 7.3-carat pink flawless from Klipdam last year sold for US\$145,000.

The company's indicated and inferred *in-situ* diamond resources are valued at US\$1.1 billion. In addition, its four diamond mines are equipped with modern processing and recovery plants and make use of a large, new fleet of earth-moving machinery.

Rockwell contracted RBC Capital Markets to provide an independent assessment of the Pala offer and RBC concluded that, for the reasons above, the bid undervalued the company significantly.

Bristow has labelled the bid as opportunistic for a number of reasons. The first is Rockwell's recent share price troubles, which he says are due as much to the turmoil in global financial markets as to Rockwell's performance. That being said, Rockwell has recently worked through several major hurdles that had a role in depressing its share price.

In July, workers at Rockwell's Wouterspan operation went on strike. A negotiations deadlock in mid-August prompted workers at the company's other operations to follow suit. Using managerial staff and non-unionized employees, Rockwell was able to maintain day-shift

production. Nevertheless, production fell by 55% in August.

Earlier in the year, Rockwell also had to deal with production delays due to South Africa's power shortages. In response, the company installed generators to enable continued production if power supply is again disrupted. In addition, costs for diesel rose more rapidly in South Africa than in many other parts of the world over the last year, providing another challenge for the junior miner.

"The good aspect of the last six months is that we've worked very hard to address issues and costs in a very structured way, right from the bottom of the business to the top, so as we move forward we'll see those benefits coming through," said Bristow in an interview with *The Northern Miner*. "They're not short-term fixes; they're really strong, underlying changes to the business that will carry us forward positively."

In addition to addressing problems, Rockwell recently built its fourth mine, called Saxendrift. The new plant and final recovery circuit are going through commissioning. When Saxendrift reaches full capacity in early 2009, it will double Rockwell's throughput to 250,000 tonnes per month from 90,000 tonnes and is expected to boost production to 26,700 carats per year from 23,000.

The company is also planning to expand Wouterspan's monthly throughput to 350,000 tonnes from 200,000 tonnes in early 2009. By 2011, the company expects to be producing 70,000 carats per year.

So the real "opportunism," Bristow notes, is that Pala's bid came directly following resolution of Rockwell's problems, while the negative ramifications are still being felt but before the upside takes effect, and just in advance of significant production increases from Saxendrift and Wouterspan.

In arguing for its takeover, Pala offered a list of problems within Rockwell and its management. The junior responded to that list when it announced the board's recommendation.

For instance, Pala claimed Rockwell has no control over costs. Rockwell countered by pointing out that industry unit operating costs have increased by more than 20% in South Africa over the past year. In the last quarter, Rockwell reduced its operating costs at Holpan to US\$3.01 per tonne, from an average of US\$3.20 per tonne over the preceding year. Similar cost reductions were achieved at Klipdam.

Pala also claimed that Rockwell mismanaged government relations, while Rockwell says Pala underestimates the complexity of South African approval processes. In fact, it says Pala's offer does not comply with South African securities laws regarding convertible securities nor with regulations around subjective assessment conditions.

And Bristow points out that a foreign company operating in South Africa requires a Black Economic Empowerment partner to hold 26%; Rockwell has such a partner but Bristow does not think the takeover would "go down well with our partner."

The claim-counterclaim list is long, but perhaps the biggest question is the motive behind Pala's move. The private equity firm has no experience operating alluvial diamond mines or selling diamond mine production.

"We just don't see a clear strategy other than that they were trying to catch us on the back foot," Bristow says. "It's either entirely opportunistic or they've got someone else in their back pocket, someone we're not aware of, maybe even non-diamond people who would like to get into the luxury products component of our business."