

Conference call transcript

16 January 2012

RESULTS FOR THE THIRD QUARTER F2012

Operator

Good day, ladies and gentlemen, and welcome to the Rockwell Diamonds Q3 F2012 results conference call. Today's call is being recorded. At this time all participants are in listen-only mode. After the opening remarks management will be reviewing the third quarter business operational results. The lines will then be opened to analysts, investors and media for questions and answers. Please be reminded that questions and answers may contain forward-looking information. This information by nature is subject to risk and uncertainties and may cause a stated outcome differing materially from actual outcome. Please refer to the bottom of the latest Rockwell Diamonds news release for more information. At this time I would like to turn the conference over to the CEO, Mr James Campbell, for his opening remarks. Please go ahead, sir.

James Campbell – CEO

Thank you. Good afternoon and good morning to all our callers from all parts of the world. We're running this telephone conference via our cell phones because the Johannesburg lines are currently down because of massive thunderstorm activity. So I hope what I have to say is clear to everybody. Welcome, and thank you for taking the time to tune into this call. Today we will report our results for the three month period to the end of November 2011 and the year to date. These represent the third quarter and first nine months of F2012. I'd like to especially welcome my capable executive team, which includes Gerhard Jacobs, our Chief Financial Officer, Michael Hunt, our Chief Operation Office, Glenn Norton, our Mineral Resource Manager, Richard Mhlontlo, our Group Resource and Industrial Relations Manager, and Jeffrey Brenner, our Diamonds Sales and Marketing Manager. Also a special warm welcome to our directors who have dialled in to today's call.

Since we last spoke, I, together with my executive team, have maintained our momentum to deliver on the strategic plan to improve our performance, although the last quarter was a challenging one. To restate my comment in the second quarter earnings call, I remain confident that we have the right executive team to drive the diamond value management culture change that is needed to unlock Rockwell's deep discount to inherent value. In today's announcement you would have seen a reference to the reorganisation of our mine management team. We did this at the end of the quarter to address some operating challenges. In addition [unclear] the senior mine managers and their immediate reports we also contributed several new appointments to enhance the skills in the company. We made these decisions by allocating resources to the areas of greatest need according to specific strengths and expertise as well as the current requirements of each operation. We are confident that these changes will make a positive contribution to our ability to sustainably deliver on our production targets.

Turning to the performance of the company. Rockwell met with a number of challenges during the third quarter. A correction in general diamond pricing affected our reported revenue. I had in fact mentioned it when concluding our second quarter earnings call that the market consolidation post the rapid price increases of the previous 12 months did not take us by surprise. I would like to provide a quick overview of our financial performance. Gerhard will provide the results in more detail.

We produced 5,334 carats at the Tirisano, Klipdam and Saxendrift operations and 5,376 carats were sold at an average price of \$1,109 per carat. The reported diamond revenues were \$8.3 million whilst our cost of sales including amortisation, depletion and impairment charges totalled \$7.7 million, which is down from \$9.2 million in the first quarter of F2011. We achieved a gross profit of \$600,000 for the quarter, so a loss of \$2.1 million was recorded which includes depreciation and depletion of mineral property interest of \$1.8 million. With Tirisano still being in its production ramp-up phase the operating costs impacted on our overall financial performance. Having changed the senior mine management team in December 2011 Tirisano now has the right people on board to meet mine targets. We also finalised the legacy Midamines matter with a one-off negative financial implication.

Our focus continued to be delivering on the objectives of the strategic review that was conducted at the beginning of 2011. These all relate to diamond value management, and we have reached a number of important milestones. Firstly, we have significantly enhanced our management and skill base. These are critical to delivering on our short- and long-term objectives of becoming a leading diamond producer in terms of our focus on value and profitability. Secondly, the rationalisation of Holpan and Klipdam with a single processing facility should enable us to profitably access the remnants of the Rooikoppie resources. Thirdly, completing the installation of the fit-for-purpose in field screen at Saxendrift will enable better efficiency and profitability at our flagship operation. Fourthly, with the completion of the Tirisano acquisition and having completed the new processing recovery facility and mining schedule as well as having replaced management we are well on our way to establishing a second profitable and long-life operation. Fifthly, we are also introducing new and appropriate technology to further entrench our value management focus, such as the bulk x-ray technology at Saxendrift which is on track. And finally, we consolidated the six prospecting and mining rights that comprised the Wouterspan property into a single mining right.

We are pleased with the progress that we have made on these fronts. We will continue to maintain our focus on addressing the key operational issues and the tasks that come with them. Once Rockwell has delivered on these management will turn its focus to bringing on stream our substantial pipeline of projects and resources. We will pursue these opportunities that fit our strategic objective of profitably producing high-value diamonds and continuing to add value to our beneficiation joint venture with the Steinmetz Diamond Group. Rockwell is well-placed to deliver on its strategic objectives and our balance sheet provides us with the required working capital to achieve our short- to medium-term plans.

And now for a brief comment on the diamond market. The volatile financial markets during the second quarter of F2012 affected the diamond sector at the beginning of the third quarter. Sentiment subsequently improved. On reopening in August 2011 the market was characterised by limited trade and extreme caution amongst traders, resulting in a price decline of approximately 30% from the record highs in May and June 2011. Wholesale polished prices declined by an average of 10% while retail prices were stable. The market turned in October 2011 and has continued its recovery into the fourth quarter with rough and polished diamond prices improving to within 15% and 5% respectively of the May and June 2011 record levels.

I would now like to hand over to Gerhard Jacobs, our Chief Financial Officer, for an overview of the financial performance of Rockwell.

Gerhard Jacobs – CFO

Thank you, James. Before getting into the numbers I'd like to highlight two points to bear in mind when reviewing the third quarter results. Firstly, on 1st September 2011 we closed the Etruscan acquisition. This is the first quarter where its results are consolidated into our financial statement. The impact of the acquisition of Tirisano included the issue of 2.6 million shares at \$1.02 to settle the purchase consideration. We also took over financial liabilities including the IDC loan and Etruscan creditors which amounted to \$5.7 million in total. As the mine was still in its ramp-up phase during the quarter we incurred the full operating costs while the revenues are still gaining momentum.

Secondly, the South African Rand depreciated by 11% against the Canadian Dollar during the third quarter, having a significant impact on the company's balance sheet. This is reflected as a negative non-cash foreign currency translation impact of \$7.1 million on the income statement. Further Rand weakness could put pressure on Dollar-denominated costs.

For the quarter the company reported revenue of \$8.3 million. Our beneficiation profit share from the joint venture with the Steinmetz Group has shown year on year growth of \$2.2 million from \$897,000 a year ago. Sales amounted to \$6 million from the sale of 5,376 carats from our three mines. Saxendrift achieved a 24% year on year improvement in sales to \$3.3 million due to a 34% increase in total carats sold to 1,761.

Klipdam sales revenue of \$1.4 million was significant lower than the comparable quarter in F2011 due to disappointing diamond value and a decrease in carats. Sales revenue at Tirisano amounted to \$1.3 million as its first sale achieved above expected prices.

We reported a gross profit of \$500,000 for the quarter, although we recorded a loss of \$2.1 million, which includes depreciation and depletion of mineral property interests of \$1.8 million. Mining costs increased marginally compared to the second quarter of F2012. This was mainly due to the inclusion of costs related to the Tirisano mine for the first time, and given that we are still in the ramp-up phase operating profit was negatively affected.

The Midamines settlement amounting to \$1.2 million, excluding interest, was paid in 2011. The total cost including interest and legal fees was \$1.4 million in the third quarter. It is important to state that the company is not aware of any other outstanding mitigation. If it hadn't been for the Tirisano start-up impact and the Midamines settlement costs we would have reflected an operating profit close to \$1 million for the quarter.

It is encouraging that on a year on year basis the average cost per cubic metre decreased by 3% to \$10.16 even though our production volumes were lower overall. A diamond inventory of 1,866 carats had been accumulated at the end of the third quarter to benefit from the higher demand during the anticipated peak sales period from January to March 2012.

At the end of November 2011 the company had cash and cash equivalents of \$11.2 million, up from \$3.7 million a year ago. We had bank indebtedness of \$400,000, down from \$2.2 million at the end of November 2010 for net cash holding of \$10.7 million compared to \$1.5 million a year ago. The company had working capital of \$12 million compared to \$9.2 million at November 2010.

It is pleasing that our net cash position is strong, having made investments of \$8.7 million in the fiscal year to date in property, plant and equipment relating to the progress at Tirisano and Saxendrift. The increased balances reflect the \$7.8 million proceeds from the [unclear] before the issue of 10.3 million shares.

The path to delivering on the financial potential of the company is still some way off. However, we are confident that with the ongoing operational improvements to enhance the recovery of diamonds, reductions in operating costs and the positive diamond price we are optimistic about the future. I would like to hand over to James again to discuss the operational performance and the strategic priorities for the rest of the year and beyond.

James Campbell – CEO

Thank you, Gerhard. I would like to dwell for a moment on safety. We unfortunately had one minor injury at Saxendrift in October which interrupted our two year LTI record at Saxendrift. Once again I wish to reiterate that both management and the operational workforce are committed to providing our employees and contractors with a safe place to work. In our previous conference call I discussed with you the culture of diamond value management which we were implementing throughout the organisation. We gained momentum with these initiatives during the year, and focussing on quality cubic metres is now becoming business as usual on our mines. In our operational discussion today I will share with you some of the key initiatives in this regard.

Mining volume declined 31% to just over 700,000 cubic metres from just over 1 million cubic metres for the same quarter in F2011. Once again the closure of Holpan had an impact, although Tirisano where we began ramping up production from mid-October 2011 dampened this effect. At Saxendrift production volumes declined 12%, while pleasingly the grade increased 42%, yielding 1,932 carats for the three months to November 2011. Klipdam achieved its budgeted recoveries in November 2011, but quarterly recoveries and quality were below expectations. We had taken decisive action to remediate this, and I will share with you in a few moments the crux of what we are doing there.

For the third quarter we produced 5,334 carats from our three operational mines. This is down 37% year on year, and the reason is mainly due to the carats lost with the closure of Holpan in May 2011. At Tirisano we produced 1,244 carats in the second six weeks of the third quarter. This countered the Holpan effect, and shows us in line with our stated intention with this acquisition Tirisano is starting to have a positive impact on our production profile.

Our overall production did not meet budget for the quarter, but we are moving in the right direction as the gap between actual and budgeted recovery is reducing. In line with our objective of reducing our unit cost it is pleasing that although the mining volume is down we achieved an average operating cash cost of \$10.16 per cubic metre, which showed a decrease of 3% from \$10.50 in the second quarter. And this includes the higher average unit costs at Tirisano, which was in its ramp-up phase during the quarter with unit costs of \$15.95 compared with our long-term objective of \$9 per cubic metre.

At Klipdam the unit costs came down almost 20% from \$11.84 per cubic metre in the second quarter to \$9.50 in the quarter under review. And this is due to the lower costs associated with mining Rooikoppie gravels, but this advantage is partly offset by lower-quality recoveries. At Saxendrift the unit costs decreased by 5% quarter on quarter to \$8.40 per cubic metre for the quarter, in line with the lower volumes of gravel processed compared to our other mining operations.

At Klipdam we migrated our mine plan from a blend of paleochannel and Rooikoppie gravels to just Rooikoppie gravels, where our recovered grades increased. The added advantage is that we can do this at lower unit cost due to less intensive earth moving and hence equipment requirements. This led to a 20% reduction in average mining cash cost, as mentioned a few moments ago.

After quarter end the mining plan migrated to the in-situ alluvial Rooikoppie gravel which has not been previously mined and is expected to yield higher quality diamonds. Carat production at Klipdam was 43% lower than in the third quarter of F2011, while volumes declined 24% due to continued intermittent front-end throughput constraints which caused the plant to operate less than optimally.

This inadequate focus on operational standards in the field caused the company to take decisive action by changing its senior mine management team there. Corrective actions were implemented, which included mining drier areas, improving the cleaning cycle and redesigning of the barrel screen, and an in field screen was erected at the centre of mining activities. These started to have a positive impact in the latter part of the quarter with improved throughputs.

A total of 1,990 carats were sold at an average of \$681 per carat compared to 2,862 carats at an average value per carat of \$1,826 in the quarter ended 30th November 2010. The drop in price was due to reduced size and quality of the diamond production from the previously worked area of the Rooikoppie gravel unit which was mined during the quarter. Management is confident that this has been addressed by migrating to a new mine area.

The focus of the mine management team at Klipdam for the next three months is to achieve the recovery of better quality diamonds in order to continue meeting their budgeted production. Volume production at Saxendrift was on target, although carat recoveries were slightly below budget. Volumes are approaching the long-term production levels previously estimated for the mine as several diamond value management initiatives begin to show results. We recovered one stone exceeding 100 carats during the quarter.

We fully commissioned the in field screening plant, and it has been producing at name plate capacity since the beginning of December 2011. The anticipated benefits of the new screening plant includes capabilities to process the high sand content in the current gravel feed that has negatively impacted performance in the past quarters. The new plant also removes significant quantities of heavy magnetic material, enabling the pans to run more efficiently in terms of diamond recovery.

The implementation of our bulk x-ray project is on schedule. The x-ray machine has been dispatched from Russia and will be set up in Johannesburg during January of this year. We expect that the x-ray unit will be commissioned and incorporated into the dedicated bulk sampling plant before we start testing. We will then move on to the performance quantification phase on various gravels which will begin during April 2012. We should be able to give you some early feedback in this regard when we announce our annual results at the end of May.

This technology which we've piloted at Saxendrift should lead to long-term improvements in diamond recoveries from the company's operations. The results will be evaluated with a view to deploying similar solutions in new processing plants that are planned at Wouterspan and Niewejaarskraal as well as Rockwell's other Middle Orange properties.

Other improvements at Saxendrift during the period include the relocation of the TC2000 excavator from Klipdam to Saxendrift, where it is operating at high utilisation. Its capacity matches that of the 100 ton trucks which transport the gravel from the mining faces to the in field stream.

Production at Saxendrift in the third quarter increased 27% to 1,933 carats from 355,000 cubic metres of gravel processed, which is 12% lower than in the comparable quarter in F2011. Recoveries gained momentum after a slow start to the quarter due to a scrubber drier failure at one of the four streams. This was subsequently resolved.

Sales at Saxendrift increased 34% to 1,761 carats at the average price of \$1,892 per carat. The 7% year on year decline was due to market correction as well as the decline in quality and size. The focus at Saxendrift for the remainder of the fiscal year is to optimise the production process for coarser diamond recoveries to increase the number of large diamonds recovered. This is being carried out as a collaborative effort between the mine's geological and metallurgical teams. The [unclear] size which has been raised to 5mm is expected to start paying off during the fourth quarter.

The acquisition of Tirisano became effective on 1st September 2011. Production started ramping up from mid-October following the construction and commissioning of the mine, including the implementation of continuous operation from start-up. A new recovery plant and front end extension were also commissioned on schedule during the quarter. Although diamond grades were disappointing in the first months after commissioning, higher than expected prices were obtained for the first stones, chiefly as a result of higher than expected recoveries of plus 10 carat stones.

Production at Tirisano during the quarter closed at 1,244 carats from 153,000 cubic metres of gravel processed. Sales amounted to 1,625 carats at an average price of \$783 per carat. Sales included product that was acquired when the acquisition became effective.

In line with the reorganisation of the senior mine management across the company's operations a new plant manager with extensive diamond winning experience and a full-time mining manager have been engaged at the Tirisano operation. After the reporting quarter the mine manager at Tirisano, Graham Chamberlain, left the company and was replaced by Ben Nel, the mine manager of Saxendrift, who has been with the group for five years. With these management changes the mine is well placed to achieve planned production during the next quarter.

The plant manager's priorities include optimising the recovery efficiencies of the plant and minimising spillage. Together with the increased supervision and consistent operation of the plant the mine is well placed to achieve planned production following the annual December 2011 shut-down.

The focus at Tirisano for the fourth quarter is to stabilise production in order to achieve budget. The geology team will continue to monitor and evaluate the mining geology in order to adjust the mine plan for specific conditions that are encountered. In addition, the company's technical team has been tasked with planning and implementing a wet front end appropriate for run of mine preparation before the next rainy season commences.

Rockwell is recognised for the large and exceptional quality stones that we produce and the quarter under review was no exception. Klipdam produced 14 stones exceeding 10 carats, including seven which exceeded 20 carats. Saxendrift produced 33 stones weighing more than 10 carats, including 12 exceeding 20 carats. Tirisano produced eight stones larger than 10 carats, including two weighing more than 20 carats.

These stones are channelled into the company's beneficiation joint venture with the Steinmetz Diamond Group, which delivers value-added revenue to Rockwell's stones that are larger than 2.8 carats. To recap, Rockwell

enjoyed equal participation in the profits from the sale of its polished diamonds sold through this channel. A significant highlight for us was the sale in November 2011 of a 35 carat D colour flawless clarity round brilliant cut diamond. It was produced from a 105 carat rough stone recovered from the Saxendrift mine in October 2009 and formed one of a pair of 35 carat diamonds. The second diamond, which belongs to Steinmetz Diamond Group, had been purchased and polished at the same time as Rockwell's stone.

The polished stones were sold as a pair at the Christie's auction, with Rockwell's diamond achieving a price of \$230,000 per carat, which included buyer's commission. We believe that the investment in the two year period from recovery to sale of the polished stone was justified given the quality of the cut and the marketing process by the joint venture, both of which maximised the value of the stone. Other investment-quality polished diamonds are regularly completed and marketed on behalf of the joint venture.

Before we conclude I'd like to provide you with some insight into the outlook for the diamond market and our priorities for the remainder of F2012. Despite the turmoil which continues to impact global financial markets the fundamentals for diamond prices remain strong. Demand extended its recovery into the fourth quarter following the [unclear] in August 2012. Anecdotal evidence suggests that the Christmas season in the USA was better than the year before in terms of diamond jewellery sales. This is expected to assist in the liquidation of inventory with the resultant cash flow improvement rolling over into the January and February 2012 rough diamond purchasing period. Rockwell expects prices and demand increase through the first half of 2012.

Having obtained the necessary approvals from the Department of Mineral Resources the Northern Cape mines will be fully converted to continuous operations by the end of January 2012. With Tirisano having been commissioned on continuous operation at outset all operations in the company will in future be operating on this basis with the dual benefits of increased production as well as higher utilisation of the processing plants. There is the added advantage of the additional jobs which will be created in these regions where unemployment is high.

From an operational perspective the priorities for each of our mines for the fourth quarter of F2012 are as follows. Firstly, in order to achieve the required returns Klipdam is targeting the recovery of better quality diamonds. For the longer term a redesign of the front end and increasing the plant capacity is under consideration. Secondly, Saxendrift is focussing on optimising the production processes for coarser diamond recovery to increase the number of large diamonds recovered. The bottom cut-off size has been raised to 5mm and is expected to start paying off during the fourth quarter.

Thirdly, the continued implementation of the bulk x-ray technology is of primary importance to Saxendrift and will be used as a pilot for deploying this technology in new projects in the pipeline. And finally, at Tirisano the experienced new mine management team which I referred to a little earlier is focussed on the delivery of its production budget. The technical team has also been tasked with planning and implementing a wet front end appropriate for run of mine preparation before the next rainy season commences.

I would like to leave you with one more important point for consideration. The long-term supply and demand fundamentals are in place for the diamond market. Demand will be driven by a substantial uptake of diamonds from China and India, while supply will gradually decrease. Both these trends bode well for the sector and for Rockwell Diamonds.

It is our duty as the management of the company to make sure that we execute on our strategy by entrenching a dedicated focus on diamond value management and bringing on stream new projects to deliver sustainable returns. There is no doubt in my mind that we now have a winning combination of the right skills and alluvial mining assets to unlock the substantial upside value in Rockwell. Although in the last months we have been in the top quartile of performance in this sector that has undergone a significant correction we believe as a management team that our share holds significant upside and it is our duty to deliver on the results to unlock this.

We will now open the lines for discussion. Thank you.

Operator

Thank you very much, sir. Ladies and gentlemen, at this time if you would like to ask a question please press star and then one on your touchtone phone. If you then decide to withdraw your question please press star and then two. I will repeat that. If you would like to ask a question please press star and then one now. Gentlemen, it appears we have no questions. Would you like to make some closing comments?

James Campbell – CEO

I think I've said sufficient. Thank you very much.

Operator

Thank you very much, sir. On behalf of Rockwell Diamonds that concludes this conference call. Thank you for joining us. You may now disconnect your lines.

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