

Earnings Call Transcript

Rockwell Diamonds Inc.

Quarter 4 Fiscal 2009 Earnings Call

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CORPORATE PARTICIPANTS

Susie Bell – Investor Relations

David Copeland – Chairman

John Bristow – President & CEO

Desmond Morgan - 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 Rockwell Diamonds Inc. Fourth Quarter Fiscal 2009 Earnings Conference Call. Today's call is being recorded. At this time, all participants are in a listen-only mode. We will conduct a question-and-answer session towards the end of the conference.

I would like to turn the conference over to Susie Bell, Investor Relations.

Susie Bell - Investor Relations

Thanks very much, Melissa. Good day, everyone, and welcome to the Rockwell Diamonds fourth quarter fiscal 2009 earnings conference call. I'm Susie Bell with Investor Relations. Today with me on the call is John Bristow, our President and CEO of Rockwell; Dave Copeland, Chairman; Desmond Morgan, CFO; and Jeffery Brenner, our Manager of Diamond Marketing and Sales.

After the opening remarks with management where we will be reviewing the fourth quarter business operational results, we will open the phone line to analysts and investors for a question-and-answer session.

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

I would like to turn the call over to Dave Copeland now for his remarks.

David Copeland – Rockwell Diamonds – President & CEO

Thank you very much, Susie. I'd like to say good morning or good evening to all the ladies and gentlemen on the call and welcome you to Rockwell's fiscal 2009 earnings call.

Firstly, I would like to remind you the format which will entail a short introduction by myself as the Chairman of the company. Thereafter I'll hand over the rest of the call to our CEO, Dr. John

Bristow, for a brief overview of the fiscal 2009 results and an indication of our forward plans for the company.

John will be assisted by Jeffrey Brenner, our Diamond Marketing and Sales Manager, and by Desmond Morgan, our Chief Financial Officer. Following John's presentation, we will take questions from participants who are on the call.

The fiscal 2009 provided a year of progress and challenges for the company. Progress saw the company finally acquire the Saxendrift mining rights purchased from Trans Hex Group in early 2007, the pre-commissioning of the fourth mine at Saxendrift in late 2008, and the recovery of an excellent array of large high-quality stones from its operations, and this included an exceptional 189.6 carat stone from Rockwell's Klipdam mine in September 2008, which achieved a price of US\$10.3 million.

Profit share from the sale of special stones manufactured by the Steinmetz Diamond Group, in particular, a 102-carat vivid yellow stone also provided excellent financial returns to the company, which was particularly satisfying given this new venture for us.

However, the company also faced considerable challenges during fiscal 2009 which were not of its making. Following the impacts of the Eskom power outages at the start of the calendar year of 2008, the company was finally granted ownership of eight of the ten mineral rights acquired from the Trans Hex Group. This was over a year after concluding the acquisition of the Saxendrift mine with the Trans Hex Group.

The impact of Rockwell's growth plans and opportunity costs to the company as a consequence of this, over-12-month-delay in granting these rights, was immense. Rockwell immediately commenced with the re-commissioning of an existing old Saxendrift plant, while starting construction on a new high volume plant and final recovery plant, which was constructed and refurbished.

Aside from the impact of the company's growth plans, the fact that development at the Saxendrift mine had to be undertaken during strong cost inflation seen worldwide in mid-2008, and in particular in South Africa, we saw spikes in oil, steel, general labor, and other prices, which presented further challenges in respect of our capital cost and prices for key components.

Rockwell also experienced industrial action in August and September of 2008, but we emerged in a much better position as a consequence of our discussions and negotiation and unionization of our labor force. In September 2008, we were the subject of a hostile bid from shareholder, Pala Investments. This bid was eventually withdrawn in November 2008. However, the dilution of management time, unnecessary expenditure of scarce financial resources to defend the hostile bid, and general disruption to the company was extremely regrettable.

And finally, you are well aware of the credit crunch and the related precipitous decline in diamond prices that occurred in the last quarter of 2008, just as we were initiating the pre-commissioning at the new Saxendrift plant.

However, the manner in which my Board, management team, and employees proactively and professionally addressed this array of challenges that Rockwell faced during fiscal 2009 was particularly satisfying, and the fact that company was still able to achieve an operational profit for the year is credited to the capabilities and resilience and determination of the company and its team. Equally, we acknowledge the role of our many supportive shareholders, who have shown considerable patience and encouragement to us over the past 16 months.

At this juncture, I would like to hand over the rest of the discussion to Dr. John Bristow and his team, to take you through the financial results for fiscal 2009.

John Bristow – President & CEO

Thanks, David, and good morning or afternoon, ladies and gentlemen, and many thanks for finding time to share our results for fiscal year 2009. The period that I'm going to cover covers the full 12-month period from March 1, 2008 to February 28, 2009. And just to point out that this is a 12-month period, whereas our previous financial year you might recall was done over a nine-month period.

As on our previous calls, we have Desmond Morgan, our CFO, and Jeffrey Brenner, Head of our Diamond Marketing and Sales group, on the call with us.

I will proceed with an overview of the activities for the past financial year in respect to production, sales, profits/loss, costs, the diamond market, and end up with a brief overview of our short and long-term plans for the forthcoming year.

In spite of the challenges that Rockwell faced in fiscal 2009, which have been noted by David Copeland, there were some notable highlights. These included the following:

- The overall reductions in our operating costs to within the company's target range of US\$3 to US\$3.50 per tonne.
- The recovery of seven stones of about 100 carats and larger, including two stones of D color, largest of which was 189.6 carats in size, and which achieved a sales price of approximately US\$10.3 million.
- Excellent profit margins were achieved from Rockwell share of stones manufactured and sold in respect to the company's agreement with the Steinmetz Diamond Group, the most notable being the sale of a 102 carats in the polished vivid yellow stone, which is cut from a 212-carat Makoenskloof rough stone. I should add that there was also another 23-carat stone cut from this large stone.
- Equally a highlight today was the pre-commission of the company's new higher volume plant at Saxendrift as well as the refurbishment of the final recovery at this fourth mine.

Moving on into the actual results, in terms of the 12 months ending February 2009, I should also just point out that although it was a 12-month period and not to contradict what I said previously, we effectively operated for nine months of the year given the fact that we lost two months due to our extended December 2008 and January 2009 shutdown, as a consequence of the credit crunch, and the freezing of diamond sales and decline in diamond prices. And equally, we lost about a month's production through August/September 2008 during industrial action that the company suffered.

So in spite of the fact that we had a 12-month period, we lost three months, we ended up with nine months of real operation:

- Mined 17,503 carats from our operations at Holpan/Klipdam, Wouterspan and Saxendrift.
- Sold 15,320.4 carats of these diamonds at an average price of US\$2,159.3 per carat. This average price was well above our modeled long-term average of about US\$1,500 a carat.
- Revenue from diamond sales were \$34.6 million, and that's Canadian dollars, and I'll spell out where we refer to US dollars.
- Our operating mining cost for this revenue was \$25.1 million.

- Our general and administrative cost amounted to \$7.9 million.
- Effectively looking at the revenue, the costs and the general and admin costs, the company achieved an operational profit of about \$1.6 million, in spite of three months of lost production.
- Adjusting for non-cash items, including share-based stock compensation, amortization, impairments, income tax, and the non-controlling shareholder interest, which reflects our Black Empowerment partner, who owns 26% of the underlying assets, we ended up with a net loss of CDN\$13 million or 0.05 cents per share.
- At the end of the year, we also held diamond inventory of 3,526 carats of diamonds.

And that summarizes the overall situation, financial position of the company, operational profits, and a consolidated loss.

The management of costs in the company remain a key focus for all of us. To this end, Rockwell's management and Board of Directors implemented rigorous and regular reviews of all aspects of our business in 2008, to address cost challenges through sustainable structural changes. At the same time, our operational projects, mineral resource, financial and service teams are all focused on improved productivity and increased efficiency.

Amongst the procedures that we implemented in fiscal 2009 to save costs were:

- The restructuring of the Middle Orange River operations,
- The placing of a mine on care and maintenance, and the reduction of our overall workforce by about 180 personnel.
- Suspension of all mining operations through December 2008 and January 2009 were also implemented to conserve cash as a consequence of the credit crunch, squeezing of diamond sales, and the strong decline in diamond prices that we experienced late last year.
- At the same time, we reviewed and rescheduled all proposed capital costs, revised mining plans and haul road layouts,
- Undertook a complete overhaul of mining methods to reduce the number of pieces of earth moving equipment utilized with each mine,
- Increased plant efficiencies by re-engineering flow circuits and conducting better repair and maintenance, replace costly desanding units with degrit screens and cyclones, and improved electrical power utilization,
- We also implemented a range of other improvements and cost cutting exercises in all service and support disciplines and non-core business areas.

Our average cash operating cost achieved for fiscal 2009 was US\$5.40 per tonne. I'm noting here that this included the three months of lost production and higher operating costs at Saxendrift during the startup of operations and the operation of the small rotary pan plant from May to November 2008.

I am encouraged to be able to report that, as of today, the average cost per tonne achieved for the first four months of fiscal 2010 is running at less than US\$3 per tonne. So that's for the four-month period March, April, May, June of this year.

Moving on to the diamond market, by way of recap, diamond prices were exceptionally strong through the initial eight-month periods of the fiscal year from March to September 2008. In September, we recovered a large white diamond, which I have commented on, and this stone realized a price of US\$10.3 million.

As noted, we also benefited last year from the sale of exceptional yellow stones, which were manufactured in terms of our marketing arrangement with the Steinmetz Group, and which were sold in October 2008.

Subsequent to September 2008, the rough diamond market experienced a sharp decrease in trading activity. And as a consequence, rough diamond prices fell precipitously in October 2008, on average by as much as 50% from the highs of the previous eight months.

Rockwell was able to sell a few of its larger stones for strong prices in early October via our agreements with the Steinmetz Group, but subsequent to this, elected to suspend all further sales into 2009.

Though diamond prices have shown an uptick about March 2009, they are still well below 2008 average prices and accordingly remain challenging for revenue and cash flow. Rockwell has noted a steady improvement in prices on the 2 to 10 carat rough range, with greatest increases in the 2 to 5 carat area. Prices of spotty and poorer quality diamonds are depressed and remain depressed, and trade is very slow in large groups above 10 carats, but good quality white stones have attracted buying.

Our estimate at this point is that prices in the 2 to 10 carat range are probably at about 60% of prior-year prices, whereas plus-10 carat stones, on average, stood about 50% below prior-year figures. Overall, we foresee that diamond prices and sales will be challenging for the remainder of 2009.

In respect of our plans for fiscal 2010, most of you will have read the circular news releases put out by the company's Executive Directors during the recent proxy contest with Pala.

By way of short-term plans, the company is committed to the following:

- A rights offering to bolster the company's balance sheet by raising about \$3.6 million, in respect of the TSX rules that permit a company to issue – or a listed company – to issue up to 25% of its share capital to raise funds for the company. Just to put that in perspective, currently the company has a cash position of approximately CDN\$2 million, diamonds on tender of about CDN\$2.5 million, and inventory of about CDN\$1 million.
- Our second priority for the year or for the following few months will be to strengthen the company's management team and implement succession planning by the appointment of a COO, adding accounting staff at its operations to further streamline our financial reporting systems, and to recruit new engineering skills.
- A further short-term objective will be to replace independent directors on the company's Board following the resignation of Mr. Greg Radke and Mr. Terry Janes recently from the company's Board of Directors.
- We will also continue with improvements in reengineering of processing and recovery plants to improve efficiencies and lower operating costs.

Over the longer term, the company has plans to achieve the following, though implementation of these longer-term initiatives will be driven by sustained improvements in diamond trading and diamond prices. The plans here include:

- The commissioning of the diamond recovery and processing plant at Niewejaarskraal, which is a high-level terrace adjacent to the Saxendrift operation in our Middle Orange River footprint area.
- We would also look to modernize and re-commission the Wouterspan operation, which has a history of producing high quality gemstones.
- Likewise, going forward, and noting improvements in diamond sales, we would continue with the evaluation through drilling and sampling of resources on existing mine sites and existing properties.
- We would also look to an assessment of the viability of other diamond projects in some of our less well-studied mineral rights holdings.
- And lastly, we do also see possible acquisitions in the future which would add value to this company.

In conclusion, in spite of facing considerable challenges at operating and corporate level, and most of all, in respect of the diamond market and prices during the past fiscal year, we are encouraged by the progress made by the company in respect of operational performance, understanding and expanding our resources, cost reductions and the ability to meet challenges not of our making.

Although our consolidated financial results are at face value discouraging, they are comparable to most other diamonds and commodity businesses who have all been severely impacted by the credit crunch, recession and sharp decline in either diamond or other commodity prices through late 2008 and into 2009. And also the fact that the company was able to generate some underlying operating profit before non-cash items, taxes and other adjustments was encouraging.

There is obviously room for improvement and considerable challenges lie ahead in respect of ensuring that the company has the ability to navigate through the challenges of ongoing soft diamond process, the weak Rand to the US dollar, and likely increased cost pressures in respect of fuel prices.

Overall, I would like to extend my thanks to the entire Rockwell team, and here I include everyone at Board level, at the operations, our Barkly West and Johannesburg offices, and to all of those we acknowledge a job well done. During fiscal 2009, the focus was on working smarter, and not harder, and I acknowledge that no doubt fiscal 2010 will be about working harder and smarter. And we are quite confident that Rockwell is up to the challenge. Thank you.

QUESTION AND ANSWER SESSION

Nicholas Barber – Murray Investments

The first question today is I wonder if you could provide further detail on Rockwell's up-to-date cash balance? And really just from the February 28th number to now, if you could give some details on the overdraft and the working capital facility?

John Bristow – Rockwell Diamonds – President & CEO

I'll ask Desmond Morgan, CFO, to do that. And bear in mind, we have both working capital, overdraft facility, diamonds on tenders and diamonds in inventory. Desmond, would you comment on that?

Desmond Morgan – Rockwell Diamonds – CFO

Right. Currently, we are – both of the operations, we are operating on an overdraft facility and at present we have CDN\$1.6 million available for operations going forward.

John Bristow – Rockwell Diamonds – President & CEO

Then just to add to that, so we would have the estimate from the diamond tender, which would be about \$2 million – US\$2 million, and a further estimate as of the last 24 hours would be another million-odd dollars in inventory.

Nicholas Barber – Murray Investments

Thank you very much. My second question would be just on the upcoming rights offering, what would be your sort of high-level use of proceeds for the funds?

John Bristow – Rockwell Diamonds – President & CEO

The prime use of funds would be working capital, bolstering the balance sheet. We're in the fortunate position of having no need to spend large amounts of capital through the year. We have spare earth-moving equipment standing idle, some of which we have been able to rent out to generate further income. So most of it would be to bolster the balance sheet and accommodate any further perturbations in the diamond market, should they occur.

Nicholas Barber – Murray Investments

Thank you. And just one question, just to follow up on that, what is your current total working capital facility? What's your maximum working capital facility that you can draw up on?

John Bristow – Rockwell Diamonds – President & CEO

That facility would be effectively the overdraft facility that we have.

Desmond Morgan – Rockwell Diamonds – CFO

We also have a further facility that we can implement, if necessary. Should the markets take longer to recover, we can implement a payment holiday for our leased equipments, which would effectively give us another approximately CDN\$1 million facility.

John Bristow – Rockwell Diamonds – President & CEO

Thanks everyone for participating in the call. We appreciate the presence of people. We appreciate the questions. And thanks, David, for your contribution and Susie. I don't know if you have anything to add, David.

David Copeland – Rockwell Diamonds – President & CEO

No, John. I think you've covered it very well. Again, I would like to extend my thanks to the entire team, especially our operating team at the operations down at Barkly West. I think we've had a very difficult year and we've come through it very tenaciously and with strength. And we've actually shown to have a profit at a particular time. I think we have the right focus going forward and we will go through the next period and we'll do better.