Conference call transcript

31 May 2011

Results for the Fourth Quarter Ended February 2011

Operator

Good day ladies and gentlemen and welcome to the Rockwell Diamonds fourth quarter fiscal 2011 results conference call. Today's call is being recorded. At this time all participants are in a listen only mode. After the opening remarks the management will be reviewing the fourth quarter business operational results. The phone lines will be open to analysts, investors and media for questions and answers. Please be reminded that comments and answers may contain forward-looking information. This information by nature is subject to risks and uncertainties and may cause a stated outcome to differ 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 call over to the Chairman, Mr David Copeland, for his opening remarks. Please begin, sir.

David Copeland – Chairman

Thank you. Good afternoon and good morning to all our callers from all parts of the world. Welcome and thank you for taking the time to tune in to this call. Today we will report our results for the three months and 12 month period to February 2011. This represents the fourth quarter, the first three months, and the annual performance for fiscal 2012, the 12 months. I also welcome the capable executive team. I am joined today by Gerhard Jacobs, our Chief Financial Officer, Graham Chamberlain, our Chief Operating Officer, and Jeffrey Brenner our Marketing Sales Manager. Also a special welcome to our incoming CEO, James Campbell, who has also taken the time to join us today before he joins us on a full time basis from tomorrow morning, 1st June. Welcome, James.

It is an exciting time for Rockwell Diamonds, and it is particularly pleasing for me that we were able to attract a CEO of the calibre of James to head up our company as it embarks on its next growth phase. James has more than 20 years experience in the diamond sector, and his decision to join is a reflection of the potential which he has seen in the company during the recruitment process. I also wish to thank my fellow director, Mark Bristol, who took on the added responsibility of acting CEO during the recruitment process, and despite his hectic existing professional responsibilities he has also made the time to work with the operational team. It is particularly pleasing to see the enormous positive impact he has had during the past five months. Now he hands over the reigns to James to put into action the next phase of Rockwell's journey.

Although James Campbell has yet to formally join Rockwell he is already having a positive impact and has raised a number of ideas which he and the operations team will implement to make sure that Rockwell meets its potential. He will be working with the operations team ensuring that our plants are optimised so as to maximise the recovery of diamonds and meet target throughput, therefore improving cash generation. He is also tasked with driving our growth strategy, in particular the second phase of developing Tirisano and the construction of the new high-volume production plant which is on the cards for Wouterspan.

Although our colleagues will discuss performance in detail we have made significant leaps forward in the past six months and I would like to highlight some of the important positive features before handing over. First it is also important to say that Rockwell's financial position showed substantial improvements during the year. However, its operational performance fell short of internal production targets. Now for some of the highlights of fiscal 2011.

Rough diamond prices continue their upward trajectory and have now surpassed the highs they achieved in 2008. We continue to streamline our support costs which came down by almost $1 million in fiscal 2011 compares to the previous year. We also have made further progress in driving down our unit costs which came in 24% lower at $7.91 per cubic metre. Production increased 5% to 26,165 carats. On the last call I mentioned that the financial indicators were all pointing in the right direction and today I can confirm this. At the operating profit level we showed a turnaround of some $7.5 million to deliver an operating profit of $4 million. Our positive cash flow from operations at $8.9 million confirms the quality of the operating profit.

Our net cash balance has improved by roughly $1 million with a net cash balance of $2.9 million at fiscal year end. It is important to reiterate that while we are pleased with the progress made to date we are still far from where we want to be. We still need to make further improvements to achieve our target production and we need to achieve further cost reductions. It is a top priority of our management team to optimise the production in order to leverage our high-capacity processing infrastructure and to minimise unit costs.

Construction at Tirisano is progressing and we will provide further details a little later during the call. One of the milestones of the fourth quarter has been an in-depth strategic review which was conducted by the management team. As a result Rockwell has aligned its corporate objectives and we have a detailed action plan with clearly stated deliverables to increase monthly production to our stated target of 10,000 carats per month within a six year horizon. An important component is the optimisation of our current mining operations which I mentioned earlier. The other key aspect is to bring new projects on stream where we already own the mining rights and all other licences that are in place. I'll add some colour around these plans a little later.

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

Gerhard Jacobs – Chief Financial Officer

Thank you, Mr Chairman. While it is pleasing that Rockwell entrenched a positive trend with further financial progress in the fourth quarter of fiscal 2011 I echo our Chairman's comment that these need to be supported by an improved production profile for the company to meet its full potential. We realised an operating profit of $800,000 compared to a loss of $2.2 million in the fourth quarter of fiscal 2010. The improvement is even more marked if one looks at the full year where we reported an operating profit of $4 million, a turnaround of $7.5 million from our loss-making position of $3.6 million a year ago. This significant improvement is due to a number of factors. The rise in diamond price and increase in carats sold were an important factor.

Our general administration costs came down from $7.8 million to $6.9 million. We also mentioned some economies of scale from higher throughput in our processing plant. The company realised rough diamond revenues of $37.8 million compares to $28 million from the previous year. Diamonds were sold at an average price of $1,365 per carat. That is up 35% from the previous year where our average price per carat was $1,010 per carat. The range of stones being sold continues to represent the production of the operations.

The stones from Rockwell's joint venture with the Steinmetz group continued to grow. The revenue for fiscal 2011 amounted to $4.7 million. That is up $1.8 million from a year ago. Just to remind you, this is our profit share arrangement on gemstones of larger than ten carats. A loss of $5.1 million or 1c per share was realised for the year. This compares to a loss of $7 million a year ago. The higher average diamond price in fiscal 2011 was an important factor in this improvement.

The company has continued to make good progress in driving down unit at its operations with an average operating cash cost of $7.91 per cubic metre for the 12 months ended February 2011 at the three productive operations compared to $10.40 per cubic metre in fiscal 2010. These unit costs were the result of increased capacity utilisation and were achieved despite increased throughput costs, higher fuel, oil and electricity prices. Rockwell achieved part of this catch-up from operating activities of $8.9 million compared to cash utilised by the operating activities of $110,000 in the previous year.

Rockwell's liquidity continues to improve with net cash holdings increasing by $1.1 million to $2.9 million. At the end of fiscal 2010 it was $1.8 million. That is after investing $12.4 million to purchase equipment and mineral properties. Debt repayments of $3.3 million rendered the company virtually debt free. At the end of

February 2011 the company's cash and cash equivalents increased to $4.8 million. At the end of fiscal 2010 it was $2.5 million with bank indebtedness amounting to $1.8 million. At the end of fiscal 2010 it was $700,000.

With the current assets amounting to $12.9 million and current liabilities of $8.6 million the company's current ratio improved to one and a half times. In February the previous year it was 1.02 times. Diamonds inventories at the end of fiscal 2011 totalled 1,057 carats compared to 3,799 carats at the end of the previous fiscal period. Thank you for your time. Graham Chamberlain, our Chief Operating Officer, will now discuss the operational performance of the company.

Graham Chamberlain – Chief Operating Officer

Thank you, Gerhard. I would like to begin with safety. Just to report that the group had a single lost-time injury for the year in review and one reportable injury for the period in review.

While the production of the company increased by 16% to 3.4 million cubic metres from 2.9 million cubic metres in fiscal 2010 this was below our internal targets.

Delays in commissioning the in-pit de-sanding plant at Saxendrift and heavy floods in January of 2011 followed by sustained high levels of precipitation impacted overall productivity. Saxendrift delivered a 19% increase in production and 261,000 cubic metres were Klipdam extension bulk sampling project.

For the year we produced 26,165 carats, which is up 5% year on year. The increase was due to carats which were recovered from the Klipdam extension bulk sampling project. Klipdam and Saxendrift were impacted by lower grades and volumes at all operations were affected by the unseasonably heavy rain and unseasonable rainfall. The Holpan mine was faced with significant challenges resulting from heavy rain and unseasonable rainfall during the fourth quarter.

Production in the fourth quarter came down by more than 30% year on year although the average grade improved to 1.18 carats per 100 cubic metres as higher grade material was mined. At Holpan resources became saturated. This had a negative effect on the volumes which the plant could process, which in turn placed upward pressure on unit costs and the mine was profitable in the fourth quarter. To address these issues we entered into negotiations with the recognised trade union, the National Union of Mineworkers, to implement full calendar operations or continuous operations. However, this agreement was not reached.

The Klipdam mine encountered similar challenges as a result of the high rainfall in the fourth quarter. Fortunately we were able to mitigate the impact by increasing the ore extractions from the palaeo channel which has a calcrete capping protecting the resource from being saturated by the rain. This was beneficial but production still came in below target, declining by 24% to 1,308 carats for the fourth quarter. This is from 183,000 cubic metres of gravel. The lower diamond recovery is in line with the natural fluctuations in the deposit grade.

Management introduced cost saving measures such as reducing the mining fleet used on the operation. On the positive side Klipdam continued to recover high-quality gemstones which have still not yet been sold at the financial reporting date.

The Holpan operation is adjacent to Klipdam, and although they have historically been run independently they have common management and support infrastructure. We have identified the potential to rationalise and consolidate these operations to extend the life of mine. Management is reviewing the available options. As a first step the company gave notice to the employees and then to the National Union of Mineworkers on 5th April 2011 that Holpan was being placed on care and maintenance. Both the Holpan and Klipdam resources will be processed through the Klipdam plant which is a pan plant and operates at a lower cost.

The annual production volume at Saxendrift increased 20% but carats recovered was down 24% because of the dilution from large sand lenses occurring in the area of current production from the deposit. Although carat volumes were lower the value of diamonds produced has remained consistent at around $2,000 per carat, confirming that the Saxendrift resource continues to produce high-quality gemstones.

The technical challenges with the in-pit de-sanding plant which we spoke about in the third quarter earnings call persisted through the fourth quarter. These were exacerbated by the unseasonably high rainfalls which reduced its effectiveness. As a result the benefits which we had anticipated did not materialise. Rockwell in conjunction with external consultants is developing a strategy to mitigate the problems.

In line with the strategic review mentioned by the Chairman during his introduction we are modifying the in-pit screening plant, making adjustments to the rotary pan plant and optimising the ore mass balance. The benefits are expected to become meaningful from the third quarter of fiscal 2012. The management of Rockwell remains confident that the Saxendrift will continue to contribute the required returns to the company.

We are still working hard to complete the acquisition of the Tirisano mine in Ventersdorp. Completion is subject to the two remaining conditions precedent. The first is a section 11 cessation by the Department of Mineral Resources, the DMR, which is well advanced and will allow Rockwell to take ownership of the mining rights. The other outstanding condition is the restructuring of the senior debt provided by the Industrial Development Corporation of South Africa Ltd when the Tirisano mine was first developed.

As you know we are completely rebuilding a 180,000 cubic metre per month production facility on the site. This plant will be commissioned later than initially envisaged as we have made a number of improvements and extensions to the initial plants. On completion though the high-volume plant is expected to benefit the company by smoothing its production profile. To date we have invested a total of $5.8 million using a combination of funds raised in the market in March 2010 as well as operational cash generated from the Northern Cape operations.

Construction started in May 2010. When it is completed in the third quarter of fiscal 2012 the new plant will comprise of four production streams, each with a monthly capacity of 45,000 cubic metres which can be run independently. It is being completed in-house using existing plants and machinery which has been redeployed from Rockwell's Wouterspan and other Northern Cape mines. The first stream started operating in April 2011 but is not fully commissioned. It is being fine-tuned by processing the ore dumps left by previous operators on the Tirisano mine. The second stream was commissioned four weeks later with the two remaining streams scheduled to be commissioned at the end of September 2011.

Commercial production will commence upon completion of the remaining conditions precedent. For now we have access to four 400,000 cubic metre dumps on the mine and we will then proceed to mine the shallower upper gravel layer of the deposit in line with the strategic review. Rockwell plans to complete a new detailed mining plan in the second quarter of fiscal 2012. This is assisted by the consultants and we will use the information generated by the SRK geotechnical study. At this point I would like to hand over to Jeffrey Brenner to provide an overview of the diamond market and to update other aspects that relate to the marketing of Rockwell's unique product.

Jeffrey Brenner – Manager, Diamond Marketing and Sales

Thank you, Graham. Good morning and good afternoon to all our listeners. Diamond markets continued to improve in the fourth quarter of fiscal 2011. Prices have now fully recovered to the 2008 levels. During the 2010 calendar year prices increased for both rough and polished diamonds. Strong demand for diamonds in the retail environment during the latter part of the 2010 calendar year continued to support improved prices.

Rough diamond supply of De Beers remained relatively low during the first half of 2010 but subsequently increased to a total value of approximately $600 million at the beginning of 2011. In addition, there was an increase of some 10% in prices, bringing prices for De Beers's rough diamonds in line with the bullish secondary market where diamonds are prepared to pay a premium on all boxes. Alrosa maintained its supply across all available marketing channels, including the tender site sales. Although it is the preferred sales channel amongst smaller producers larger producers are increasingly adopting tender sales as a suitable sales mechanism.

Although the pace of price increases for polished diamonds has not matched that of rough diamonds the trend has been positive. The growth in the Indian and Chinese domestic markets has led to an increase in market share at the retail consumer level which includes accelerating on-mine sales. Polished diamond prices in particular increased by 5% during January and February 2011. Since the 2008 crash rough diamonds are increasingly being considered as a commodity as well as an investment. More high net worth individuals and alternative investment institutions are investing in polished diamonds, especially rare, expensive polished diamonds which are typical to Rockwell's production. These large and expensive diamonds have delivered substantial returns in value over the years. Diamonds are a depleting natural resource with no major discoveries of new deposits since the 1980's. As a result investors who appreciate diamonds as a store of value have become a strong force amongst diamond buyers.

The average price achieved in fiscal 2011 was $1,345 per carat, up 35% from the $1,010 per carat received in the prior year. Eight tender sales of Rockwell rough diamonds were conducted during the year. Sales amounted to 27,017 in fiscal 2011 compared to 26,533 in the previous year. Rockwell recovered 38 stones exceeding 10 carats in size during the fourth quarter of 2011. These diamonds were sold into the company's joint venture with Steinmetz diamond group, and once polished and sold will provide additional profit share revenue to the company. I would like to hand over to our Chairman, David Copeland, for his concluding comments. Thank you.

David Copeland – Chairman

Thank you, Jeffrey. I'd like to thank Gerhard, Graham and yourself, Jeffrey. I'd also like to thank Graham and all the operations team for a very good safety record this year, and I look forward to further improvements on the safety coming up this next year as well.

To summarise, our financial performance in the fourth quarter showed a significant improvement, but we have a way to go on the operational side in order to achieve our internal production targets. Having completed the strategic review to map the way forward for our company we know what we need to do. Our focus is on implementing this strategy to unlock the inherent value of the company.

There are two specific areas of focus in order for Rockwell to further improve its financial health, maximising the effectiveness of our existing operations and investing in a pipeline of projects to extend our production profile. In terms of our improving existing operations we will continue to take decisive action. By achieving designed plant throughput rates and improving both utilisation and availability we can reduce costs. In addition, the company will pursue sustainable improvements in its metallurgical processes to improve the recovery of diamonds and consequently increase revenue. This includes engaging the services of world-renowned diamond metallurgical and technical and economically assessed plant processes at all the mines including Tirisano. This analysis and subsequent optimisation are expected to start yielding benefits in the second half of physical 2012.

Completing the high-volume production plant in Tirisano is also a top priority for the first six months of physical 2012 and is an important step in delivering on our objectives to predictably produce more carats every month. We need to follow on from that to leverage the potential value of the projects that we have in the pipeline. To this end we evaluated the available options and selected two projects with the highest projected returns. Once the Tirisano production plant is complete and bedded down we will embark on the second phase of this development by constructing an excavation and conveyer system to provide access to the southern ore body. We will also construct a high-volume production plant at Wouterspan using the process of raising capital externally to fund these developments.

The fundamentals for the diamond market are strong with robust demand and pricing. Rockwell is positioned to benefit from these positive fundamentals with inventories of 1,000 odd carats. The outlook for Rockwell Diamonds is underpinned by strong fundamentals in the diamond market. Our team of alluvial diamond, geology, mining and processing experts is unique and we have skills across the value chain from exploration to processing and recovery of diamonds. It was recently strengthened with the appointment of our new CEO, James Campbell, to lead the execution on our strategy.

With the ongoing operational improvements enhancing the recovery of diamonds, reductions in operating costs and the increasing prices and demand for diamonds, the positive trend in the company's financial performance over the last four quarters should be sustained in physical 2012. I'd like to thank all our listeners for your interest and taking the time to participate in the call. Once again we extend our gratitude to Rockwell shareholders, our directors and management and other stakeholders for their committed and continued support of Rockwell's growth and development plans. We will now open the lines for questions. 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'll repeat that. If you'd like to ask a question please press star and then one now. We will pause a moment to see if we have any questions. It appears we have no further questions. Would you like to make some closing comments?

David Copeland – Chairman

Again I would like to thank all our shareholders and stakeholders for taking the time, and we look very forward to an exciting and expansive year for the period 2012. Should there be any questions please feel free to contact our investor relations people at any time. Thank you again, David Copeland.

Operator

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

END OF TRANSCRIPT