# Earnings Call Transcript

## Rockwell Diamonds Inc.

## Quarter 3 Fiscal 2011 Results Call

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**CORPORATE PARTICIPANTS**

**Jeffrey Brenner** – Manager, Diamond Marketing and Sales

**Graham Chamberlain** – Chief Operating Officer

**Dave Copeland** – Chairman

**Gerhard Jacobs** – Chief Financial Officer

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

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### Operator

Operator: Good day, ladies and gentlemen, and welcome to the Rockwell Diamonds' Third 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 where management will be reviewing the third quarter business operational results, the phone lines will be open to analysts and investors for question and answers.

Please be reminded that comments and answers 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 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 Chairman, Mr. David Copeland, for his opening remarks. Please begin, sir.

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### David Copeland – Rockwell Diamonds – Chairman

Yes, good morning, good afternoon to all our callers from all parts of the world. I appreciate you very much tuning into this call. Welcome to Rockwell's earning call in which we will report our results for the three-month period to November 2010, representing the third quarter of fiscal 2010.

I will be ably assisted by Gerhard Jacobs, our Chief Financial Officer; Graham Chamberlain, our Chief Operating Officer; Jeffrey Brenner, our Diamond and Marketing Sales Manager. We'll also have on the line some of our operation managers from Barkly West in the Northern Cape and Ventersdorp in the Northwest.

I would like to comment that after we made the results public on January 14, 2011 it came to Rockwell's attention that an error had occurred on consolidation of the financial results. Accordingly, the reported revenue and cost of sales were overstated and will be adjusted in a subsequent announcement by the company on the TSE and the JSE Limited as soon as practical.

Let me assure you there is no effect on the bottom line as the income statement impact is offset between revenue and cost. Therefore, the operating profit and net loss for the three months ended November 30, 2010 remain as reported on the MD&A as well as the financial statements.

The overall result is that the reported revenue and the cost of rough diamond sales should be adjusted by amount of $5.3 million. Accordingly, the correct revenue should have been $11.1 million instead of $16.4 million. While the correct cost of rough diamond sales is $5.9 million versus the higher reported figure of %11.2 million. Again, there is no change to the bottom line.

At this juncture, I'd also like to comment on the position of John Bristow, who until recently was President and CEO of Rockwell. John resigned as CEO and President, as we announced on December 14, 2010 but he will stay on as a Director taking on special assignments and consulting activities. And he will be very much available during the professional handover to a new CEO. An intensive selection process has been embarked upon sometime ago and a number of candidates are being discussed.

My colleagues will discuss the performance in more detail, but I would like to cover a few highlights of the third fiscal quarter of 2011. These include the following:

- Rough diamond prices continue their strong recovery during the quarter;
- Again, we continue to attack our operating costs and the lower cost for the quarter which came in at US$6.31 per cubic meter. This is within Rockwell's target range of US$6 to US$7 per cubic meter; and
- Rockwell showed an operating profit of $1.8 million following a loss of some $600,000 in the previous quarter. These results indicate the company's operational performance is improving underpinned by the recovery of rough diamond prices; the sale of a number of good quality stones; and despite, we did not meet all of our production targets.

For fiscal year-to-date both carat production and the prices received showed increases. However, although it's also pleasing to see the arrows are pointing in the right direction, we still have some way to go to meet our production and further cost reductions.

Rockwell produced 22,519 carats of diamonds compared to 19,920 carats during the comparable period in the previous year. The company delivered a satisfactory operational performance overall with the Vaal River operations exceeding expectations. The company's bulk sampling at the Klipdam

Extension also continued due to this improvement.Saxendrift was behind on expectation in relation to carats mined, but this will be addressed in greater detail in the operational discussion.

Construction at Tirisano is progressing well and we will provide further details, a little later during the call.

In order to deliver on our planned growth objectives, we will require additional capital for Wouterspan and Tirisano as we progress, which are our next development milestones for Rockwell. However, we are very confident and once they are up and running, we will be able to fund our expansion from internal resources. These untapped resources measure some 56,000 hectares of high-quality properties containing alluvial diamond deposits.

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

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## Gerhard Jacobs – Rockwell Diamonds – Chief Financial Officer

Thank you, Mr. Chairman. Rockwell showed further encouraging financial progress in the third quarter of fiscal 2011 realizing an operating profit of $1.8 million compared to a loss of $614,000 in the previous quarter. The year-to-date results confirmed this positive trend with an operating profit of $3.7 million compared to an operating loss of $2.3 million for the same period in the prior year.

In the third quarter, the company realized rough diamond revenues of $11.1 million compared to $11.3 million for the previous quarter. Diamonds were sold at an average price of US$1,566 per carat, indicating an improvement of more than 49% from the second quarter with the range of stones being sold, being representative of the operations production.

The profit share value-add by Rockwell's joint venture with Steinmetz Diamond Group continues to grow. The revenue for the quarter includes US$800,000 of returns from the profit share arrangement on gemstones larger than 10 carats.

While real diamond revenues declined marginally from the second quarter, the operating profitability of the company improved by $2.4 million due to the higher average revenue per carat sold and a marginal improvement in the cost of production per unit.

An overall loss of $1.4 million or $0.003 per share was realized for the three months to the end of November 2010, compared to a loss of $1 million or $0.002 per share in the second quarter.

The company maintained its focus on reducing units costs through operational optimization.

An average operating cash cost at the three productive operations of US$6.28 per cubic meter was achieved for the nine months, which is well within the company's target range of US$6.00 to US$7.00

per cubic meter. By increasing the throughput in line with the strategic objectives of the company, there are further unit cost benefits to be leveraged.

The average total cash cost for all operations over the first nine months of fiscal 2011, including rehabilitation, lease payments and royalties amounted to US$7.49 per cubic meter, which is down from the US$8.21 per cubic meter for the comparable period. The 20% increase in production volume had a positive impact on the fixed portion of the unit costs.

In the three months to the end of November 2010, cash flow from operating activities amounted to $2.7 million, which was up from the $1.1 million in the previous quarter, reflecting the improved operational performance.

The Company was cash positive with net cash holdings of $1.5 million, compared to $2.1 million indebted at the end of November 2009. At the end of November 2010, the company’s cash and cash equivalents increased to $3.7 million with bank indebtedness amounting to $2.2 million. In total, the company had working capital of $9.4 million at the end of November 2010, compared to the deficit of $4.1 million in the previous year.

Diamond inventories at the end of the quarter of fiscal 2011 totaled 3,865 carats, compared to the 2,801 carats in 2009.

Thank you for your time. Graham Chamberlain, our Chief Operating Officer, will now discuss the operational performance of the company.

## Graham Chamberlain – Rockwell Diamonds – Chief Operating Officer

Thank you, Gerhard. Production at Rockwell’s mining operations continued to increase quarter-on-quarter, reaching approximately one million cubic meters for the third quarter. This is an increase of 3% from the second quarter. Notwithstanding the positive trend, our volume achievements are short of our own internal targets on both gravel moved and carats. And I will provide more background on operation – on operation by operation basis as we move on.

On a fiscal year-to-date basis, 2.8 million cubic meters of gravel have been moved. This is up 20% on the comparable nine months prior. And we produced 8,404 carats of diamonds for the same period. This is a 6% increase year-on-year. On a quarter-to-quarter basis, the carats produced were 24% higher.

We have been engaging with the recognized union, the National Union of Mineworkers on changing our current five-day shift cycle to a seven-day or a continuous operation cycle. This will not only boost production, but also stimulate employment in the Northern Cape area.

Diamond production at Holpan was ahead of expectations for the third fiscal quarter and carat production of 2,131 carats was up 1%. This was produced from 233,000 cubic meters of gravel. The volumes were down 4% quarter-on-quarter and slightly below plan. The improvements due to mining operations was conducted in a higher grade mining areas. This area was targeted for mining during the dry months as the high clay content makes a difficult wet season mining. The increase in carats was due to the favorable grades which increased 5%. Included in this was the recovery of 21 stones which exceeded 10 carats. And we have spent considerable effort reworking and elevating the roadway infrastructures in preparation for the wet season.

Sales from Holpan increased to 1,412 carats at a higher average value of US$1,015 per carat. This compares to 2,556 carats at an average value per carat of US$240 in the third quarter of the fiscal 2010.

As a result of the lower sales volumes, inventories have increased placing us in good position to supply rough stones into the market as anticipated higher demand seasonality kicks in during February. These factors influenced all the operations.

Klipdam also delivered a much improved performance on the back of higher grades in the third quarter, producing 3,756 carats from 255,000 cubic meters of gravel, up 79% quarter-on-quarter. This is due to a change in the ore ratios with the proportion of the paleo-gravel to the old riverbed gravels increasing to 70% where they used to be 40%.

Sales from the quarter under review from Klipdam were 2,862 carats with an average value – carat value of US$1,826. Although this represents a decrease quarter-on-quarter from 3,578 carats, the average value per carat more than doubled from US$558 per carat during the same period.

Inventories have increased in line with the production for the quarter, with the reasons being similar to those outlined a few moments ago with respect to February sales.

Production from the Klipdam Extension, the bulk sampling operation, which underwent pre-commissioning in late May 2010, was 946 carats produced with 118,000 cubic meters of gravel with an average price of US$860 per carat. The first phase of resource delineation and bulk sampling to attain a representative diamond sample to ascertain the grade, metallurgical characteristics, and economics of the deposit has now been completed.

At this point, the company has put the bulk sampling exercise on hold, while it assesses the results. When this process is complete, the company will be in a position to ascertain the long-term viability of this deposit.

The investment in the Saxendrift mine more than two years ago has proven to be positive for Rockwell even though the third quarter production was slightly behind target. Production decreased by 18% to 1,527 carats and it was produced from 405,500 cubic meters, down 4% on the previous quarter.

As expected, we are entering the areas of the ore body that contain sand lenses. The addition of sand to the recovery process has the effect of displacing diamond-bearing material. This has a negative effect on the grade, which came down 15% quarter-on-quarter. To negate this effect, we have constructed a dry de-sanding plant close to the center of gravity of the remaining ore body. This was commissioned in November 2010. And in addition, we have installed a new scrubbing circuit on one of the four production lines. Although, we encountered technical challenges during commissioning, management is actively working to resolve these issues.

To fully understand the extent of the sand problem and to manage the grades and the planning processes more effectively, the company has appointed additional geologists to map and delineate the areas of future mining.

Although this production was down, Saxendrift continues to produce high quality gemstones for which it is known, as reflected by the average price achieved per carat, which increased 21% to US$2,034 from the previous quarter. However, carat sold declined to 1,316 carats.

In March of 2010, Rockwell announced that it had reached an agreement to purchase 74% of the Etruscan Diamonds Limited well known the Blue Gum diamond operation in the Ventersdorp region in the Northwest province of South Africa.

The Blue Gum Project hosts the Tirisano alluvial diamond deposit. The mineral resources comprised of 25 million cubic meters of indicated resources at a grade of 2.37 carats/100 cubic meters, as well as 15 million cubic meters of inferred reserves with a similar grade per 100 cubic meters.

The mine's production comprising an average stone size of 0.9 carats and a consistent grade is ideally suited to the bridal market which will help create a more regular quarterly production volumes for the company.

Completion of the Tirisano acquisition is still subject to Section 11, the South African mining ministry consent, which is well advanced, as well as the relevant securities regulatory approvals including the Toronto Stock Exchange and certain conditions precedent which are being progressed by the company.

Rockwell is making steady progress with the engineering and fabrication of a new, high-volume, low-cost processing plant and the implementation of the new mining plan at the Tirisano project.

An agreement between the parties allows for construction work, contract mining to be undertaken by Rockwell, whilst they're waiting for the conclusion of the legal process. Because the construction process is being managed in-house and by redeploying processing and mobile equipment already owned by Rockwell, there is a benefit gained of saving on capital requirements and related costs. Completion is targeted for early fiscal 2012.

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?

## Jeffrey Brenner – Rockwell Diamonds – Manager, Diamond Marketing and Sales

Thank you, Graham. Good morning and good afternoon to all our listeners. During the past three months, the diamond market's recovery gained momentum with prices trending towards 2008 levels. The pace of recovery has not being at an equal rate for rough diamonds and polished diamond prices - prices paid for rough diamonds are high whereas prices of polished stones are improving more slowly.

Rough diamond prices have increased mainly due to a perception of shortages in certain items. Another cause is the extended credit issued by Indian banks to their diamond trading and manufacturing clients. As a result, Indian traders have dominated the market forcing prices of rough diamonds upwards, while polished diamonds have moved only marginally.

The Indian domestic and Chinese markets continued to increase their consumption of diamonds and expand their worldwide market share. Rough diamond producers continued to increase their production levels. Supply of rough diamonds is pertinent to the success of downstream traders and direct supply to traders is very limited, because the majority of diamonds in secondary markets are supplied by way of the highly competitive tender process.

The average price achieved in the first nine months of fiscal 2011 was $1,345 per carat, a significant increase from the $969 per carat received in the prior year period.

Four tender sales of Rockwell rough diamonds were conducted during the nine months to the end of November 2010 of special diamonds exceeding 10 carats were sold regularly for a profit share by the beneficiation joint venture with the Steinmetz Diamond Group.

During the quarter under review, Rockwell recovered eight large gemstones from its Holpan, Klipdam and Saxendrift operations, bringing to 19 the total number of stones exceeding 50 carats recovered during the current fiscal year. Once manufactured and sold as polished goods, these stones will provide additional profit share revenue to the company under the terms of the joint venture with Steinmetz Diamond Group.

Flawless Diamond Trading House which became 20% owned by Rockwell during the first quarter of fiscal 2009 is in the process of integrating a diamond cleaning technology - the first of its kind to be implemented commercially - that would enhance the appearance of rough diamonds presented for sale.

I would like to hand over to our Chairman for his concluding comments. Thank you.

## David Copeland – Rockwell Diamonds – Chairman

Thank you, Jeffrey. And I'd like to thank Gerhard, Graham, and Jeffrey again. To summarize in the third quarter, fiscal 2011, Rockwell continued to make progress towards achieving its strategic objective of building a unique gemstone diamond producer with a long-term capacity of 9,000 to 10,000 carats per month within the next six years. Our approach has not changed and I would like to recap the following:

- We are proceeding with the evaluation of our existing and defined resources to identify future projects that will add to the company's growth profile to create value from our extensive portfolio of mineral rights holdings.
- As stated a number of times in the past, we plan to develop further production capacity at Tirisano and Wouterspan. Although, as mentioned earlier, these are well underway, but we will still need to raise additional financing to complete and deliver on these plans. Once these mines are in full production, we will also pursue further optimization of these operations and continue to attack our operating costs.
- In the longer term, the company will also look to additional organic growth opportunities of its Niewejaarskraal property to the West of Saxendrift, but only once Tirisano and Wouterspan are fully bedded down and in good operational format.
- The company is confident that Rockwell will be able to expand its production profile by developing its high-quality project pipeline, thereby increasing production and revenue profile to create an operating entity which adds value from its internal cash flow.

As one of only a handful investible diamond companies, Rockwell has significant upside potential which is underpinned by its portfolio of three operational alluvial diamond mines and several other very near-term projects. The company has already benefited from the recovery in the diamond market and the outlook remains positive with demand from the Chinese and the Indian markets creating strong support for prices. Rockwell's aim is to continue to optimize and increase the production capacity of its assets and to deliver sustainable production growth and unit cost benefits in line with its long-term growth objectives.

I'd like to thank all our listeners for your interest and taking the time to participate in the call. Once again, we extent our gratitude to Rockwell's 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 line for questions. Thank you.

## QUESTION AND ANSWER SECTION

**<Q – James Allan>:** A question for you Jeffrey, there is quite a high level of inventory in terms of carats, and of course the question is what are the quality of the carats in terms of size and quality as well, but also, was it a deliberate policy of yours to hold diamonds back anticipating a stronger market in the February period?

**<A – Jeffrey Brenner>:** Hi James, thanks for the question. Firstly, the quality of the diamonds is the same as it has been in the past, it's fairly consistent. And secondly, traditionally January and February are stronger selling months, for rough diamonds that is, compared to the December period and that is the main reason why we hold back the diamonds. All the diamonds will be sold within this quarter.

**<Q – James Allan>:** Okay. So I mean, from what you said, would I assume that, on a sales price basis, the carats that you've held back would average around about the same average dollar to carat that you got in this slot- through November?

**<A – Jeffrey Brenner>:** Yes, you can assume that, James.

**<Q – James Allan** You raised nearly CAD$17 million and you're now down to – I can't remember what the number was, but it was 1.5 million or somewhere around about that. Can you give me a breakdown of where the cash has gone?

**<A – Gerhard Jacobs>:** I'm just going to go to our cash flow statement. Obviously, not all of that cash was raised during the current financial year, some of it was raised in the previous financial year as well. But most of the cash expended went into some of the capital projects where we looked at the basement in Tirisano as well as some of the design phase for Wouterspan.

**<Q – James Allan>:** Can you give me how much went into Tirisano? I mean what's your total cash investment in Tirisano today?

**<A – Graham Chamberlain>:** Tirisano to-date, it's some $2.6 million that's gone into Tirisano, including care and maintenance ..

**<Q – James Allan>:** Okay, what about Wouterspan?

**<A – Gerhard Jacobs>:** Wouterspan, I think probably $1.5 million there but I don't have the numbers in front of me, but it's in the region of about $1.5 million fo design and some deposits.

**<Q – James Allan>:** Okay,That's quite a long way short of the 17 million that was raised.

**<A – Gerhard Jacobs>:** And as well, there was a big contribution, if you look at our finance lease obligations, where we do those obligations, so most of our equipment is almost fully paid so by the June 30th of next year we would settled all of that debt in terms of our yellow capacity so a lot of that has gone towards repaying that debt.

**<Q – James Allan>:** You know, I mean you talk about needing additional capital to complete Tirisano and Wouterspan, how much additional capital are you talking about and what are your plans for raising this?

**<A – David Copeland>:** Well, I can talk about the plans, if Graham wants to talk about the additional capital. Just while Graham is gathering his numbers, what we would look at is some form of probably a private placement. We're looking at a number of different op and talking to potential funding scenarios.

**<A – Graham Chamberlain>:** Well there are two aspects to this. Gerhard mentioned we spent some money on the designs of Wouterspan. Those are basically concluded. They will undergo a review process shortly, that's by an independent third party. We will also need them to refine our capital estimates there post review. With regard to Tirisano, what we've done there – and this is just to explain again,  back backtrack a little bit. The original plan was to develop a plant to process 90,000 cubic meters per month. When we were constructing and doing the designs, we thought it pertinent to construct a plant that could do double that, in other words do our Phase I and Phase II constructions at the same time. This brings forward production but it delays the start date and that is why we've said we would start in the first quarter of the fiscal 2012. We've spent to date, I think Gerhard mentioned it, but it's about ZAR18 million, that includes the cost of care and maintenance. We would require an additional – at this stage we're firming up on the numbers, but it's estimated around ZAR35 million to complete the second part of the plant expansion and we need now to determine the yellow fleet, we need to double the size of the yellow fleet.

**<Q – James Allan>:** Okay. And what sort of a capital estimate have you got for that, Graham, in terms of doubling the size of the yellow fleet?

**<A – Graham Chamberlain>:** It's in the order of ZAR15 million as well, but we're looking at various options so that this is perhaps not something that needs to be financed, there are various options. That's why I say we need to firm up on our numbers so that we know what capital money we need to raise, the rest we could perhaps put on to an operating cost and that is what I'm referring to, is either contract mining or very low-cost mining that we could do ourselves with own equipment. We've got a very innovative manager on that side and we are looking at some innovations.

**<Q – James Allan>:** Okay. But we're looking at sort of minimum of $5 million for the plant that you're talking about, that ZAR35 million?

**<A – Graham Chamberlain>:** That's full expansion of the plant, Phase 2,– we've got a southerly section to the ore body which needs to be transported to the mine so we need an in-pit screen and we need a conveyor system. We're not going to truck it to that distance, it's about two kilometers. That infrastructure would cost ZAR35 million. And as I said there's two options to look at with the yellow fleet, either purchase and own operate or we contract out.

**<Q – Stephen Pearce>:** Good morning. Thank you for this very interesting report. I'm an investor in Rockwell Diamonds and have some question about the capitalization, with 500 million shares outstanding and your interest in an additional private placement. From the investor world, having a stock that trades at $0.07 puts it off-limits to a lot of investors. I'm wondering whether there are any plans to do a reverse split or to somehow contract rather than expand the number of shares?

**<A – David Copeland>:** Well we have – as a Board, we've been looking at a number of options. We recognize the concerns of having that size float, although not untypical for a lot of Australian entities, but I can say as a Board we're looking at options as how to better reflect the value of the company through a potential consolidation or some other means. We've yet to decide on any of those factors. We have not as of yet, but I can tell you they are under discussion.