

Earnings Call Transcript

Rockwell Diamonds Inc.

Quarter 3 Fiscal 2009 Earnings Call

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CORPORATE PARTICIPANTS

Susie Bell – Investor Relations

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. Third Quarter Fiscal 2009 Earnings Conference Call. At this time, all participants are in a listen-only mode and we will conduct a question and answer session at the end of the conference call. As a reminder, today's call is being recorded.

At this time, I would like to turn the conference over to your host Susie Bell, Investor Relations. Please go ahead.

Susie Bell – Rockwell Diamonds – Investor Relations

Thanks very much Trisha. Good day and welcome to Rockwell Diamonds Third Quarter fiscal 2009 earnings conference call. I am Susie Bell with Investor Relations. Today with me on the call is John Bristow, President and CEO of Rockwell; Desmond Morgan, our CFO; and Jeffrey Brenner, our Manager of Diamond Marketing and Sales.

After the opening remarks by management, where we will be reviewing the Third Quarter business and operational results, we will open the phone lines 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 John now for your remarks. Thank you

John Bristow – Rockwell Diamonds – President & CEO

Thanks, Susie, and good morning and good afternoon, ladies and gentlemen. And once again, thanks for finding time to share our results for Quarter Three and for the first nine months of fiscal year 2009. Just to ensure that we got the dates right, the quarter cover the periods September through November 2008 and the nine months March through November 2008.

I will proceed with an overview of activities for the three and nine-month periods, particularly in respect of addressing costs, I will present our financial results in summary and comment on our plans to deal with the current tough market conditions, and then briefly map out our plan going forward. And as Susie noted, Jeffrey Brenner is with us to comment on the diamond markets, and Desmond Morgan, who joined us as our new CFO in October, is here to take questions on the financials.

I will labor that the cost-saving mechanisms and work we did through 2008 to contain and reduce costs in a structural manner, mainly because we believe that these procedures that we have put in place will stand us in good stead in the challenging year ahead.

Moving on, Rockwell has achieved excellent profits in the third quarter of fiscal 2009 and was profitable, both at an operational and consolidated level for the nine month period through the end of November 2008.

Equally encouraging was that our overall cost trends for the three and nine month period ended downward after peaking and plateauing in Quarter Two, due to spiraling cost increases in key mining supplies and services, which impacted negatively on local and international mining companies during 2008.

The Company also successfully commissioned its fourth operation at Saxendrift at the end of the year.

During the nine month period, Rockwell experienced a number of challenges:

- A hangover from Eskom power outages in this country which necessitated spending approximately \$1.5 million of unbudgeted funds, and that's Canadian I should add, unbudgeted funds purchasing and installing backup generator sets at our operations;
- We equally experienced sharp increases in electrical power costs in the year;
- Steep increases in diesel, oil and lubricant costs;
- Strong steel price increases which had an impact on all aspects of our business, bearing in mind that we purchase and buy yellow earth moving gear, which is largely steel and most of our plants are steel based;
- We had a labor dispute, which resulted in the loss of 35% of budgeted carat production in the second quarter;
- We also experienced wage and other cost increases driven by the strong overall inflationary conditions in the South African environment through 2008;
- We had an unsolicited offer for the Company, which took up a lot of management time;
- And, we had a weakening of the Rand, which although helping diamond prices certainly also passed on added costs of imported goods and steel.

We did not let these tales of woe get in our way and in spite of these challenges, the Company was able to contain and reduce costs in a sustainable manner, open its fourth operation at Saxendrift and achieve overall profitability.

Rockwell's management and Board of Directors implemented rigorous and regular reviews of all aspects of our business in early 2008 to specifically address cost challenges through sustainable structural changes. At the same time, our Operations Manager, Bruce Cubitt, and Hennie van

Wyk, our Project Manager, and the entire operating, project and geological teams, all focused attention on improving productivity and efficiencies at the operation.

Among the procedures that we implemented in line with these initiatives driven by management and the Board:

- Detailed studies on a project basis to better characterize our resources and improve our knowledge of grade distribution;
- A revision of mining plans and haul road layout;
- A complete review and overhaul of mining methods to substantially reduce the number of pieces of earth moving equipment utilized at each mine;
- Increases in plant efficiencies by systematic review and improvement of each flow circuit, better repair and maintenance, replacement of costly desanding units with much simpler and lower cost degrit screens and cyclones, and improved electrical power utilization;
- We made improvements to training, HR management, and communication with our employees;
- We improved our data recovery – our data analysis, information gathering and reporting systems so that all of this information would be available to us more quickly and I am happy to report that our SYSPRO management accounting and reporting system is showing distinct benefits to the Company;
- We also made ongoing improvements within our corporate governance procedures including that of a plan to suppliers and contractors, and we implemented a transparent and very robust procurement policy, which has provided significant cost savings without bringing the Company to a halt – comparatives of Quarter-on-Quarter purchases are difficult but whereas cost of sales for Quarter Three of the previous fiscal were \$9.5 million, they were only \$3.7 million dollars for this latest quarter three in spite of the fact that we are now running a fourth operation;
- We made reviews and changes to all our non-core activities and contract arrangements to again improve management of such services and outsource non-core activities, and thereby, sensibly also cut costs.

All of these activities are ongoing and all of the changes have provided benefit to the Company by way of cost savings and improved operational efficiencies. They will play an important part in allowing us to manage the Company through the turbulent and challenging times that we face in the months ahead.

If we then move specifically to our financial results, including the production figures for the period – the three-month period ending November 30, our results, as I said, were particularly satisfying against the background of industrial action and lost production in the previous Quarter.

Highlights of Quarter Three were:

- Production of nearly 6,000 carats from mining operations, to be specific, 5,981.25 carats. Here, I wish to note that the Company currently holds 5,619.24 carats in inventory due to market events that we are all familiar with and due to the fact that we had cash in the bank which has allowed us to manage the Company through the past three months without being a forced seller;

- In the quarter, we sold 1,997.24 carats at an average price of US\$6,762.76 per carat for revenue of \$16.2 million. This high average value and the strong revenue was obviously helped by the sale of the exceptional 189.6 carat white stone that we sold in this period;
- Cost of sales and amortization totaled \$6.5 million and net general and administrative expenses amounted to \$1.9million. This was offset by a small net tax recovery of \$134,035, resulting in:
 - An operating profit of \$9.5 million;
 - A net profit of \$4.5 million or \$0.02 per share.

If we move on from the quarter to the nine months period ending November 30, 2008:

- We produced 16,558 carats, of which 11,965 were sold at an average price, which again was also excellent, US\$2,538 per carat, and yielding revenue of \$33.2 million for the nine months;
- Our cost of sales and amortization totaled \$24 million in that nine-month period, and net general and administrative expenses amounted to \$6.5 million. In this case for the nine months, we had a net tax recovery of \$1.2 million, and the loss on the sale of a discontinued operation of \$203,338, resulting in:
 - An operating profit of \$9.5 million;
 - A net profit of \$1.4 million or \$0.01 per share.

Obviously costs, I have already covered some of this, remain a key consideration for the Company; to recap we experienced sharp increases at the end of the First Quarter, which plateaued in the Second Quarter. Subsequently, aggregate mining costs and unit mining costs decreased to year-end, and as of November 30, 2008, we ended up with the unit cost of about \$3.50 per tonne, which is well within our target range of \$3.00 to \$3.30 per tonne.

The focus going forward will obviously be to sustain the situation, and here Saxendrift is important to the future of the Company. I should just add that although the U.S. Dollar and the Dollar-based unit cost is obviously important in this business, Rockwell also focuses considerable attention on Rand-based costs in so much of our day-to-day activities and costs thereof are Rand-based. Dollar-based costs, and particularly the unit costs are also strongly influenced by the Rand-Dollar exchange rate, hence making it important for us to track Rand-based costs. And again, I should just stress that we do not only focus on the unit costs, but aggregate costs, be they mining costs or head office costs are also very closely monitored and tracked on an aggregate basis.

Moving onto the diamond market, by way of recap, diamond prices were strong through the six-month period ending August 31, 2008. In September 2008, Rockwell recovered a large white 189.6-carat gemstone from the Klipdam mining operation. This stone realized an excellent price of approximately US\$10.2 million. The Company also benefited through the sale of three exceptional yellow stones, which were manufactured, were cut and polished in terms of our marketing agreement with the Steinmetz Diamond Group and these were sold in October 2008.

Subsequent to September 2008, the rough diamond market has experienced a sharp decrease in trading activity and as a consequence, rough diamond prices have fallen or fell sharply in the latter part of 2008. Rockwell sold a few of its larger stones from production with strong prices in early October via our arrangement with Steinmetz but subsequent to this we have not sold the greater parts of our production from the Third Quarter, and as I indicated previously, we currently have diamond inventory of 5,619.24 carats.

I will leave it for Jeffrey Brenner to provide comments on how we see the diamond market at this point in time and going forward. Like others out there we look forward to professional input from the highly experienced diamond analysts that we have on the call, Des Kilalea and James Allan.

As noted above, the Company has expanded its operations to four from an original three with the re-commissioning of facilities and the mining operation at Saxendrift on the south bank of the Middle Orange River, adjacent to our Wouterspan operation.

Aside from the re-commissioning during the Second Quarter of fiscal 2009 of the existing small scale Saxendrift plant, which we acquired with the package we purchased from Trans Hex, in November 2008, the Company also pre-commissioned a state of the art, low-cost, high-volume wet Rotary pan plant at Saxendrift. This plant was built and pre-commissioned on-budget and on-time in approximately five months and was operating routinely prior to our shutdown at the end of November. The intention of this plant is to rapidly step it up to production of about 300,000 tonne per month and then beyond that we look to further increase its production capabilities.

The refurbished Saxendrift, new final recovery facility was also commissioned a month ahead of schedule in late September 2008, and has worked very successfully since then. Both the new wet plant and this final recovery facility are very important for the Company going forward given that they provide us with large capacity, hopefully a lot more diamonds and very low operating costs.

Further to our cash position, the Company ended the third quarter of fiscal 2009 with cash reserves of \$6.8million and these funds have been utilized by the Company to provide us the flexibility during extended shut-down period through December and January.

Looking at the market late last year and through the Christmas period, we initially shut down the operations from November to 5th of January and then elected to extend this to the end of January. This was obviously in relation to the present conditions in the diamond market and to ensure that we could conserve cash and thereby help sustain the Company in the long term.

Currently, we plan to reopen operations at the beginning of February. Given challenging conditions in the markets, Rockwell has also initiated a process to restructure its Middle Orange River operations, so as to further save costs and improve efficiencies.

Upon our planned resumption of operations at the end of this month, the Company will focus on ramping up the Saxendrift mining operation, with operations at Wouterspan will be suspended to reduce costs, and at the same time we would look to reopen Holpan and Klipdam.

The intention would also be in the short to medium term to fabricate and re-commission a low cost twin 18-foot rotary pan plant and replace the older, high cost operating 12-foot rotary pan plant at Wouterspan.

I should also point out here that we do not intend to go and splash a lot of CapEx to do this. We have a lot of plant and equipment already that we would include in the fabrication and commissioning of the new, or the proposed new Wouterspan plant.

In conclusion, Rockwell is encouraged by our strong results, cost reductions, and the profitability achieved for the three and nine-month periods to November 30 of fiscal 2009. Over the period, the Company demonstrated flexibility and fleet-footedness, which allowed us to overcome challenges such as power outages, spiraling electrical, fuel, oil, steel and other costs, industrial action, and an unsolicited offer for the Company.

The Company has also proactively taken steps to address the present conditions in the international diamond market and as noted, we are in the process of restructuring our Middle Orange River operations and at the same time also non-core service department.

We will suspend operations at Wouterspan as indicated, and through the restructuring process, also regrettably, retrench employees. At this point in time, we are in negotiations with our staff and the National Union of Mineworkers to address this and achieve it in a constructive fashion.

We are also closely monitoring the situation in the polished and rough diamond market, as well as results of rough diamond tenders that may be conducted by other producers. To-date, there has not been a lot of sales activity in the diamond business, and particularly in the alluvial sector, and we are expecting the early tenders to kickoff next week, and that hopefully will give us insight into where we see the market going.

Looking forward to the next three and six months, our plan is to cut costs further, ensure that the Company can operate profitably in build, and commission a high-volume, low-cost wet plant at Wouterspan as soon as we are on a position to do so. We would then look to reopen Wouterspan, market permitting, and run at a far lower cost, or operate at a far lower cost with higher volumes and in the process, obviously, re-employ people that were laid off.

We are addressing the latest market challenges head-on, and we have just held another series of site inspections and meetings to review all operating procedures as indicated, to look at where possible and necessary in restructuring and retrenchment. And at the same time, we also introduced some of our new Board members to the Company.

Most of all, we are mindful of the challenges ahead and aware that they will most certainly have an impact on diamond sales, revenues in the financial performance of the Company in the short to medium term.

Nevertheless, based on the hard work done in 2008 where the emphasis was on working smart rather than just working hard, we are confident that we have put changes and building blocks in place that will allow us to go forward in a sustainable manner.

We also do have funds in the bank. We obviously have carats in the bank and all of that should help us weather the challenging months ahead.

Finally, I would just like to thank the entire Rockwell team, and here I include everyone at the operations, Barkly West, here in Johannesburg, and our Board of Directors some of whom have now left us for a job well done through 2008. Equally, as I've said, we look forward to a challenging 2009. Thanks, everyone.