

Earnings Call Transcript

Rockwell Diamonds Inc.

Quarter 1 Fiscal 2011 Results Call

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CORPORATE PARTICIPANTS

John Bristow – President & CEO

Graham Chamberlain – Chief Operating Officer

Johann Oosthuizen – Financial Manager Operations

Jeffrey Brenner – Manager, Diamond Marketing and Sales

Glenn Norton – Manager, Mineral Resources

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

Operator

Good day, ladies and gentlemen, and welcome to Rockwell Diamonds First 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 first quarter business operational results the phone lines will be open to analysts and investors for a question-and-answer session.

Please be reminded that comments and answers may contain forward-looking information. This information by its nature is subject to risk 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 things over to the President and CEO, Mr. John Bristow. Please go ahead sir.

John Bristow – Rockwell Diamonds – President & CEO

Good morning and afternoon ladies and gentlemen. Welcome to Rockwell's earnings call in which we will report results for the three months to May 31, 2010, representing the first quarter of fiscal 2011.

I will be assisted by Graham Chamberlain, our Chief Operating Officer; Jeffrey Brenner, our Diamond Marketing and Sales Manager; Johan Oosthuizen, our Financial Manager; and Glenn Norton, our Mineral Resource Manager.

Prior to proceeding with the presentation of the results, I would like to note that further to our year-end and quarter one results, Rockwell has elected to report production and cost data in terms of cubic meters or cubes rather than on a per tonne basis as was the case in the past. This is in line with the conventional industry standards for alluvial deposits.

We have also published the conversion factors to convert cubes or cubic meters to tonnes. This was done on the quarterly MD&A and also in our company news release of late last week.

As a rule of thumb, cubes can be converted to tonnes by multiplying by a specific gravity factor of about two, grades that may be expressed in carats per cube or carats per hundreds of cube can be converted to

carat per tonne or carat per hundred tonnes by dividing by the same specific gravity factor, rule of thumb as I said, the number two.

With respect to the first quarter of fiscal 2010, during the first two months Rockwell's three operations: Holpan, Klipdam, Saxendrift underperformed against budgeted production targets, but exceeded budgeted carats in May. This was primarily the results of weather factors and higher sand content in the ore bodies which impeded plant throughputs and processing capacity. Remedial action has been put in place to mitigate these challenges.

The company has implemented the construction of an in-pit screening facility at Saxendrift that will remove the fine sand fraction and oversized gravel components and effectively produce a pre-concentrate ore that will be transported to the processing plants. This will result in cost savings in respect of transport and diesel for the simple reason we will be tramming less raw material to the plants. That will ensure we can do greater processing capacity through the plants, and we will have quicker rehabilitation, thereby providing additional savings.

In May, Rockwell pre-commissioned its Klipdam extension bulk sampling project to the east of the Klipdam mine. This plant is evaluating alluvial diamond properties that the company holds in the vicinity of Klipdam and Holpan with a view to developing further production capacity from properties that yield good results in terms of grade and diamond value. Although the production has been somewhat behind schedule at this Klipdam extension, the carats recovered at the end are very good quality and indications at this stage is that the grade predictions we made prior to implementing the commissioning, will be in line with what we have achieved so far.

Good progress has been made with the design, re-engineering and revised costing of the Wouterspan processing plant to build a high volume low cost mining and processing operation. The company has however delayed the construction and re-commissioning of Wouterspan to ensure that front end engineering enhancements made at Saxendrift can be incorporated into the new Wouterspan plant design. These design improvements will ensure greater throughput capacity and further lower operating costs for the plants, and will also provide an important template for subsequent construction of other similar plants at Niewejaarskraal in the Middle Orange River as well as the Phase 2 expansion that we have planned for Tirisano in the future.

Rockwell has also progressed well with its plans to complete the acquisition of the Tirisano project in the Ventersdorp area 150 kilometers west of Johannesburg. I'll return to this project towards the end of the presentation.

Lastly, you would have seen in our news releases that we acquired a 20% holding in Flawless Diamond Trading House which provides marketing and sales services to the company. This is seen as a strategic investment to generate additional revenues and be able to get closer to the trends and developments in the international diamond market and I should add without subtracting from Rockwell's core business which is to be a focused alluvial diamond miner.

In respect of financial performance, in the three months ended 31 May, 2010:

- Rockwell mined 7,368 carats at Holpan, Klipdam and Saxendrift operations as well as the Klipdam Extension bulk sampling plant.
- 4,927 of these carats were sold at an average price of US\$1,611 per carat. That US\$1,611 per carat was well above our long-term average of US\$1,500 per carat that we used in our financial modeling and planning scenario.
- Tender sales of US\$7.9 million were achieved from sales of diamonds.

- Rockwell also realized \$300,000 in terms of beneficiation profit share from our joint venture with the Steinmetz Group
- Overall, diamond sales were US\$8.2 million or the equivalent \$8.5 million in terms of Canadian dollars
- Cost of sales including amortization, depletion and impairment charges totaled \$6 million. There is a fair value adjustment on investments of \$100,000, recognized in the quarter. And overall the combined amortization, depletion and impairment charges were \$3.1 million for the quarter. From this, Rockwell achieved an operating profit of \$2.5 million.
- Our net general and administrative expenses amounted to \$1.4 million, travel and conference expenses amounted to \$100,000, interest expenses were also \$100,000 and future income tax expense was \$300,000.
- Overall, in terms of the consolidated bottom, Rockwell realized a loss of \$30,000. But this was encouraging given where the company had come from in the prior financial year. So, obviously we are very focused on improving the financial situation of the company going forward.

Our diamond inventory at the end of May was effectively 4,351 carats, though we were in the midst of a sale cycle. So, most of these carats were sold at the end of May and into early June. As of today, our inventory is back at 4,800 carats and the company has approximately \$7,000 cash in the bank.

Moving on, management of costs remains the key focus for the company:

- The average operating costs over the quarter for the three operations and the Klipdam Extension was US\$6.68 per cube or US\$3.32 per tonne, which is well within our target range of US\$6 to \$7 per cube that we forecasted for fiscal 2011. For the prior 12-month period, operating costs were US\$3.11 per tonne. So, in spite of the fact that we are now developing a fourth trial mining operation, our unit cost per tonne only increased marginally for the quarter.
- The average total cost for all the operations over the first quarter of fiscal 2011, including rehabilitation, lease payments and royalties, was effectively a round figure US\$10 per cube, or about US\$5 per tonne. These costs, as I noted, include the pre-commissioning of the Klipdam Extension bulk sampling project.
- In the previous 12-months, our total cost was about US\$5.23 per tonne. So again, we are encouraged by the fact that we have systematically reduced our total costs downward for the period.

In respect to diamond production, Rockwell produced some excellent gemstones during the quarter, including a 56 carat white gemstone from Holpan, and stones with 125 carats and 145 carats from Saxendrift. We did also recover a 100 carat stone from Klipdam, but this is unfortunately a low value industrial or boart stone. With the recovered number of plus 10 carat stones in line with our statistical prediction and we have seen good recoveries in terms of quality and size at Klipdam and Klipdam Extension in the latter part of the quarter and during June and July.

In terms of the diamond markets, following the steady improvement in prices through the latter part of calendar 2009, the trend has continued into calendar 2010, helped by the firm and responsible stewardship of De Beers and Alrosa, the Russian mining company, who continued to ensure that there is no sudden oversupply to the market, either from new production or diamond stockpile held by the Gokhran, which is the Russian State Company that buys most of the Russian production prior to on sale to the market.

The U.S. diamond market has shown some improvement in demand, particularly for polished. There has been a slight improvement in overall polished prices and demand for rough diamonds and diamond jewelry remains healthy in China and India, while the rest of Asia continued to show resilience.

Rockwell has seen the benefit of the price improvements that I have just referred to, both rough and polished pricing levels, and that was reflected in our strong average dollar per carat price of US\$1,611 per carat for the quarter. I should add here that the strong dollar prices obviously helped by a very good quality parcel, which we sold at the end of May and June and which included the three large stones from the single stone from Holpan and the two from Saxendrift.

In terms of overall market trends, in our view there has been a slight price softening of about 10% or thereabouts, depending on size and quality, in line with the normal seasonal slowdown as the European and North American holiday seasons sets in. We are confident that this is a seasonal trend, and that there is likely to be an upturn in pricing once trade resumes after the holiday period.

In respect of our plans moving forward, in March 2010, the Company signed a term sheet to acquire 74% of the Tirisano or Blue Gum Diamond project located in Ventersdorp region of South Africa from Etruscan Diamonds Ltd for an amount not exceeding Rand 33.5 million, that's approximately \$4.6 million payable in Rockwell shares. The Tirisano property holds an alluvial diamond deposit with 25 million cubic meters of indicated mineral resource and 15 million cubic meters of inferred mineral resources, both at an estimated grade of 2.37 carats per 100 cubic meters, which in terms of carats per 100 tonnes, would be about 1.1 carats per 100 tonnes and I would like to just note this, because this is a significantly higher grade than our operations down in the Northern Cape. The Tirisano operations are currently on care and maintenance.

The high grade of the Tirisano deposits compared to the low grades of Rockwell's Northern Cape operations and there we typically average about 0.4 carats per 100 tonnes, or 0.7 to 0.8 carats per 100 cubic meters and large volume of the Tirisano resources will facilitate high production rates and greater consistency of carat production, thereby smoothing the company's revenue stream.

Completion of this acquisition is subject to several conditions. The most important one being Ministerial consent for the transfer of the mineral right from Etruscan to Rockwell. This process is on track, and both Rockwell and Etruscan are actively engaged with the Department of Minerals to ensure the process is completed as soon as possible, and in line with the Ministry's new objective of expediting, permits and consents to transfer mineral rights rapidly to assist the growth of the industry.

Rockwell has an experienced and small construction and mining team onsite. We have been tasked to ensuring we can reconfigure and restart the rotary pan plants rapidly once the mineral rights transfer is complete. At the same time, we have rebuilt the geological model, reconfirmed our resources and are advanced with the technical study, which will ensure we can optimize the mine design, pit layouts and mining sequence.

As noted, we are effectively looking to fast track the re-commission of Tirisano. As noted again, the reason for this is the higher grade compared to our lower grades in the Northern Cape, which as far as we are concerned, will help smooth our production and give us consistency of carat production and then with the added benefits of the large diamonds that we typically recover in the Northern Cape show us stronger revenue and profitability going forward.

In the short-term, we are effectively bringing the Tirisano project ahead of Wouterspan, for the reasons that I have outlined to you.

Overall, we see Tirisano as being a key new foundation of the company's growth and development strategy and thereafter, we will redevelop the Wouterspan project as an additional building block in our growth plans.

Over the next five years or so, the company is committed to building Rockwell into a unique gemstone producer, leveraging off the production base and projects that we already have producing diamonds. To achieve our long-term plan, we will increase the rate of evaluation of our existing mineral resources, including those that are already defined as mineral resources and other properties that we hold, where we have not yet done sufficient work to be able to define either indicated or inferred resources. Obviously, in this respect, the Klipdam extension project is most important. We do have a big ground holding in both the areas around Holpan and Klipdam and equally in the Middle Orange River. And unless we evaluate these projects and develop them, we will end up having to give the properties back to Department of Minerals and Energy.

In terms of our long-term plan, we also planned to commission further production capacity by way of expansion phases at Wouterspan and Tirisano. In both these cases, we have extremely large resources and we will look to upgrade in a modular fashion the mining and plant operations that we have established at Tirisano and at Wouterspan.

Equally, in the longer-term, we plan to construct a new mine at Niewejaarskraal in the Middle Orange River. This property is a high-level terrace. It has very similar characteristics to Saxendrift, and we have work and material produced by the TransHex Group, from whom we acquired the property, showing that the grade and the diamond quality are very similar to Saxendrift. For this again is an important part in the long-term plan for Rockwell.

Overall, the intention is to expand Rockwell to produce about 10,000 carats per month, and thereby create a unique producer of rare high-value gemstone diamonds.

With the international diamond business showing a progressive fall in existing mine production, and no new discoveries of consequence on the horizon. Rockwell's strategy of targeting the high-end gemstone production puts the market fundamentals of declining supply and increasing demand, driven by the exceptional growth we have seen in the Chinese and Indian markets and the steady improvement we are seeing in the U.S. markets.

In the long-term, we therefore see Rockwell being ideally positioned to produce diamonds at the top-end of the market and fill a rare and unique niche area in a growing demand situation with decline in supply.

I thank you all for attending the conference call and taking the time to participate and extend our thanks to Rockwell shareholders, our directors, management, and employees and other stakeholders that are committed to Rockwell's long-term growth and development.