Conference call transcript

August 12, 2011

Results for the First Quarter EndedMay 2012

Operator

Good day ladies and gentlemen and welcome to the Rockwell Diamonds first quarter fiscal 2012 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 first 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 CEO, Mr James Campbell, for his opening remarks. Please begin, sir.

James Campbell – CEO

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 month period to May 2011. This represents the first quarter for fiscal 2012. I also welcome my capable executive team. I am joined today by Gerhard Jacobs, our Chief Financial Officer, Michael Hunt, who joined as our Chief Operating Officer on the 11th of July 2011, Glenn Norton our Mineral Resource Manager who has been with Rockwell since the start and Richard Mhlontlo, our Group Human Resources and Industrial relations manager. Also a special welcome to the directors who have dialled into today's call.

It is my first earnings call as CEO, having joined the Company on the 1st June 2011. It is therefore opportune for me to share my reasons for joining the Company with you today, as well as my plans for the Company to close the value gap between our current share price and its fair value. As you all know, I have been in the diamond industry for some 25 years with leadership positions in De Beers, African Diamonds plc and Lucara Diamond Corporation. During the process of making my decision, I spent three days on the operations and came to the conclusion that Rockwell had the building blocks of a successful mid-tier alluvial diamond mining company. It was clear to me that the Company had spent an enormous amount of time and money analyzing its geology and diamond resources which it now understands in great detail. This is a critical success factor for a profitable alluvial diamond miner. The grades and diamond values in our NI 43-101 reports are supported by actual production data and sales prices in addition to sampling estimatesas well as being verified by an independent qualified person. This approach gives us comfort that the estimates are conservative which is, important as we begin to optimise our current processes and implement improved concentration and recovery technology.

Although the Company's production profile has been volatile and suboptimal in the last few years, I saw ample evidence that by focusing on diamond value management and 'quality' tons, these issues could chiefly be resolved. And, I believe that by taking decisive action in the past two months, we have begun to demonstrate that we have the will and the expertise to turn the Company around. During today's call I will discuss some of the major actions that have already been taken, as well as our plans going forward.

I mentioned the value gap a few moments ago. At its current market capitalization of some $20 million, the Company is trading at about one third of the book value of the property, plant and equipment on our balance sheet. Based on the diamond values that we have disclosed in our NI 43-101 technical reports, the in situ value of our diamonds is more than $1.5 billion. We have also conducted an independent valuation that was completed in July 2011 and which confirmed the intrinsic value of the Company. The evaluator concluded that the discounted cash flow value of the company's assets lies in the range of $165 million-$185 million. On a weighted basis, a combination of the recent share price, a peer group comparison and the discounted cash flow values gives a trading fair value of some $60 million. Given that the share is trading at such a discount shows that this number is conservative. It is ourchallenge,as the management of Rockwell, to turn these underperforming assets around in order to unlock the intrinsic value in the company. We are committed to achieving this.

Those of you who've been following news flow in the last several months will have seen that there has been a great deal of activity in order to begin the turnaround of Rockwell. I will discuss the operational initiatives during today's call but would like to highlight a few of the management changes because it is only by having the right people in my team that we can effect the change:

- One of the first things I did when I started at Rockwell was to engage the services of a world renowned diamond metallurgist, Dr Kurt Peterson. Under his leadership the optimization of the company's production plants is taking place.
- Graham Chamberlain, our previous Chief Operating Officer agreed to assume the critical responsibility of General Manager, Tirisano, focussing his time on successfully developing this asset which is one of the Company's most strategic assets, in order to ensure that it meets its full potential.
- We have also brought a new Chief Operating Office on board, Michael Hunt, a seasoned diamond production specialist and a professional engineer and metallurgist with more than 30 years' of diamond industry experience.

I would like to dwell on the salient features of the quarter for a few moments before handing over to Gerhard for the financial overview:

- Our beneficiation revenue from the joint venture with Steinmetz trebled to $943,842
- We reported stable total revenue of $8.5 million
- Our rough diamond sales price has continued to strengthen and we recorded a slightly higher average price of US$1,631 per carat

- Our efforts to drive down cost are beginning to deliver and we showed a 19% reduction in general and administration expenses
- We reported a gross profit of $0.5 million and an operating loss of $1.2 million
- Production decreased 40% to 4,428 carats due to unseasonal rain in the Northern Cape. Rockwell's top area of focus in the year ahead is to stabilize the production profile, because if we get our production right in the current diamond market, we will be well positioned to deliver good returns to our shareholders
- We continued to be cash generative, reporting net cash inflow from operating activities of $1.9 million, a year-on-year turnaround of $3.0 million
- We have a net cash balance of $3.0 million after we spent $2.2 million on further capital investments at Tirisano which will only start to contribute revenues towards the end of the year

The fundamentals in the diamond market remain positive. During the 2011 calendar year to date, demand for diamonds has underpinned the accelerating price increases of both polished and rough stones. Initially, when the recovery started after the 2008 downturn, prices for small diamonds accelerated more quickly but the value of larger diamonds has recently caught up. The strength of the market was recently confirmed with De Beers' latest market allocation that occurred in the second week of May when prices increased by 15% across the board.

The price of polished diamonds is expected to increase in the longer term, relieving margin pressure in the manufacturing environment. Since the beginning of 2011, diamond prices have increased by some 50%, and demand continues to support prices at these levels although the rate of increases is expected to settle somewhat.

With respect to Rockwell's product, prices have continued to improve in calendar 2011, although the rate of increases did not match the levels experienced at the end of 2010. Rockwell has a natural price hedge on its production of larger diamonds which are sold into the Steinmetz Diamond Group beneficiation joint venture. This JV is unique to Rockwell and creates a significant differentiator for us against our peer group.

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

This is the first quarter where the results have reported under IFRS with Canada having adopted IFRS from the beginning of 2011.

Rockwell's financial health continued to improve during the first quarter of fiscal 2012 even though, as James mentioned, production fell short of our expectations. Several indicators in our financial results demonstrate that we are still on the right track to improve our financial position:

The Company delivered stable total revenue of $8.5 million for the quarter, underpinned by diamond prices which continued to strengthen. However, revenue growth was limited by lower inventories available for sale during the quarter as well as disappointing production due to legacy issues at the operations which were exacerbated by the unseasonably long rainy season. Carats sold in the first quarter decreased 3% year-on-year to 4,779 at a marginally higher average price of US$1,631 per carat. The beneficiation joint venture continued to grow during the quarter, and tripled in value to $943,842.

The Company continued to generate cash as reflected by the net cash inflow from operating activities of $1.9 million compared to a net cash outflow of $1.0 million in the comparative quarter. Rockwell preserved its net cash balances at $3.0 million, after making capital investments of $2.2 million at the Tirisano project.

The Company reported a gross profit for the quarter of $502,716. An operating loss of $1.2 million compares to an operating profit of $329,776 in the comparable period of the previous fiscal year, mainly due to the $2.9 million inventory movement recorded in 2010.

Mining costs for the three months ended May 31, 2011 amounted to $5.9 million, which excluded amortization and depletion charges of $2.0 million.

General and administration expenses declined by 19% to $1.8 million.

Legal, accounting and audit expenses decreased to $213,416 for the three months ended May 31, 2011 compared to $359,026 in the comparable prior period.

Stock-based compensation decreased to $128,298 for the three months ended May 31, 2011 in comparison to $220,981 for the same period in the previous year.

Net interest expenses were $1,851for the three months ended May 31, 2011, compared to $124,167 for the three months ended May 31, 2010, due to the reduction of the outstanding capital lease obligations and interest recieved.

At May 31, 2011, the Company had cash and cash equivalents of $6.6 million and a bank overdraft of $3.6million, for net cash holdings of $3.0 million which is in line with the figure at the end of February 2011.

The Company had no long-term debt at May 31, 2011, other than reclamation obligations relating to its Klipdam, Holpan, Wouterspan, Niewejaarskraal and Saxendrift mines which are majority funded. The capital lease obligations relating to mining equipment of which only $40,175 is outstanding at May 31, 2011 will be fully repaid within the next three months. The Company’s capital lease obligations are denominated in South African Rand (“ZAR”).

Based on monthly production projections the Company should hold adequate inventory that will generate sales revenue and has adequate cash holdings as well as access to short-term debt facilities to meet its working capital requirements.

I would like to hand over to James again to discuss the operational performance and the strategic priorities for the rest of the year and beyond.

James Campbell – Chief Executive Officer

Thank you, Gerhard. I would like to start the operational discussion with safety. It was with regret that we reported that a fatal accident occurred at the Tirisano mine project on June 17, 2011 when an employee suffered fatal injuries at a conveyor belt installation on the mine. It was the first fatality suffered by Rockwell in its operating history and was dealt with in the most serious light possible.

In the operations environment, we have adopted a philosophy of “quality tonnes” and diamond value management which has beenincorporated into all our operational functions. In the past, the focus was more on volume throughput and this allowed processing inefficiencies to creep into the system. By concentrating on quality and value, we aim to show consistent improvement in the recovery of diamonds and efficiency of our plants.

The volume throughput of the Company’s mines decreased by 22% to 593,164 cubic metres for the quarter which was well below our internal targets. This is chiefly in that the rainy season lasted well into the first quarter which is highly unusual and productivity was impacted as we had to process wet gravels. The closure of operations at Holpan also had an impact. Volume production at the Saxendrift operation was stable for the quarter.

The Company continued to focus on reducing mining costs across all operations. Although unit costs were impacted by the lower volumes, the average operating cash cost for the productive operations was US$10.48 per cubic metre compared to $11.41 a year ago, chiefly due to currency fluctuations. Closure costs as well as those associated with the ongoing care and maintenance at Holpan negatively impacted on the cost profile.

For the quarter we produced 4,428 carats, which is down 40% year on year – in line with the lower guidance which we gave for the quarter at our previous earnings call.

Holpan’s production for the quarter halved to 903 carats as mining and processing efficiencies were impacted by the high clay content in the Rooikoppie gravel related to the prolonged rainy reason. The closure of the mine also had an impact.

Material for the Klipdam plant was primarily sourced from the Palaeo channel. The mitigation measures which we have put in place to address the impact of higher rainfall started to pay off but the plant processes were still impacted by wet gravels. Looking forward into the second quarter, Klipdam has begun to focus on the processing of quality material and the efficient recovery of diamonds under the new leadership team.

At Saxendrift, the persistence of sand lenses impacted efficiencies in the recovery of diamonds and the recovered grade declined by 42%, although the stones that were recovered continued to be of a high quality and fetched an average price of $2,686 per carat which is up 10%. We are making progress to resolve the challenges with the in-pit desanding plant which we reported back on several times in previous calls. We conducted an independent review of the mine's processing plant and from the findings, the Board approved the replacement of the current vibrating screen with fit-for-purpose technology that is specifically designed to process wet and sticky ores at the required processing rates.Other initiatives are also being evaluated to improve plant efficiency.

We finally have some good news to report in relation to the acquisition of the Tirisano mine in Ventersdorp. After the reporting date, we fulfilled the last conditions precedent for the acquisition of this property from Etruscan. The senior debt which was provided by the Industrial Development Corporation was restructured in July 2011 and the Section 11 cession approval from the DMR was received early in August 2011.

We also undertook a plant review at Tirisano which came up with a number of recommendations to improve the processing plant which had been built under the previous leadership. Tirisano is an important building block in Rockwell's growth strategy and we needed to make sure that the processing plant would deliver on our expectations. As a result, we modified the commissioning schedule and the first two production streams of the plant will now go into production at the end of the third quarter of 2011 ramping up to a monthly capacity of 90,000 cubic metres. Our metallurgists are currently reviewing the flow diagrams for the new front end and we plan to completeconstruction early in fiscal 2013, depending on the availability of capital. The remaining two streams will be redesigned to implement processing technologies which support Rockwell's diamond value management strategy. This work will commence within three months of production so that we can take into account all the learnings from the first two streams.

Improving our asset allocation has been another area which has received close attention over the last two months. The strategic review that we have mentioned on a number of occasions also included an investigation to ensure that all our equipment and properties is being fully utilized. Early in fiscal 2012, three assets were identified that were not generating adequate returns, namely a PC 3000 excavator at the Wouterspan mine, the DMS plant from Holpanwhich has been closed and a small mining property, Makoenskloof. These were sold for a total of $6.5 million. These funds have been allocated to the capital project budget and will supplement the current capital raising activities, reducing the total quantity of funds required and limiting dilution to the immediate benefit of all shareholders.

Last week we were delighted to announce that 373 carats were recovered at Rockwell's Saxendrift mine representing approximately half of the mine's budgeted monthly production in a single day. This is not only a record at the mine since it has been owned by Rockwell, but the highest daily production ever achieved within Rockwell's five year operating history. Among the stones recovered were four large stones weighing 180, 94, 43 and 34 carats. This came after we had recovered three other exceptional stones at the mine late in July, one of which weighed 128 carats and two smaller D colour stones. Rockwell's competitive advantage in the diamond world is the regular production of large high quality diamonds and although recoveries such as recently experienced at Saxendrift are rare they enhance the profitability of our mines.

With regard to making investments to increase its production profile, the new management team has reviewed the investment priorities and is currently closing off on the private placement which has been mentioned in several recent news releases. In June, we announced a strategic refinancing plan including a $2 million convertible bridge loan from Daboll Consultants Ltd., an affiliate of the Steinmetz Diamond Group. This was the first step in the planned recapitalization. In order to achieve our objective of increasing the production profile to 10,000 carats per month within five years, we will need to access additional capital. The current private placement is to fund the plant improvements at Saxendrift, the ongoing development of the Tirisano mine as well as preliminary work on a new plant at Wouterspan. These well thought out investments will put Rockwell on a strong footing to embark on the next phase of its investments.

Steinmetz has once again shown its confidence in our plans with a subscription for shares amounting to $5 million as part of the current private placement at a price of $0.75 per share. A special shareholders' meeting to approve the transaction is scheduled for September 9, 2011.

We are committed to completing the current projects at Saxendrift and Tirisano before embarking on our plans to develop the Wouterspan and Niewejaarskraal mines. Both of these properties have extensive mineral deposits which have historically been mined with recoveries similar to those at Saxendrift, in terms of size, quality and average price per carat. New high volume processing plants are planned, incorporating the latest technologies in diamond recovery which have been shown to be significantly more efficient than traditional DMS and pan plant configurations. The timing of these new developments will be predicated on the availability of funding with a preference for using internal cashflow; however, these may need to be supplemented by external capital.

I would like to provide guidance on the second quarter of fiscal 2012. Although carat production in June and July 2011 was disappointing, the strong production of diamonds in the last two weeks should enable the Company's performance for the second quarter to at least match the results for the same period in fiscal 2011.

In particular the exceptionally large, high quality stones which I mentioned a few minutes ago which were recovered at Saxendrift in early August; should enable the mine to deliver on its budget for the quarter. At Klipdam, a process to optimize volume throughputs to the plant has begun and there are early indications that it will lead to improved diamond recovery.

Inflationary pressure on mining expenses, particularly in relation to fuel, power and labor, is an area which Rockwell is monitoring closely in addition to its overhead expenses in order to achieve further cost reductions. The efficiency initiatives encompassing the diamond value management approach are being aggressively implemented at the operations and are expected to start paying off in the third quarter of fiscal 2012.

Another critical aspect of the Company's turnaround at Saxendrift and Klipdam is the proposed introduction of continuous operations at these mines and management continues to negotiate with the DMR and relevant unions in this regard.

The fundamentals for the diamond market remain strong, underpinned by growing demand from China and India. While prices increased by some 50% in the calendar year to date, the Company anticipates that the market could see more normalized increases as it enters a short period of consolidation.

I firmly believe that Rockwell has the potential to unlock significant value for shareholders, and that the results of our current efforts to turn the underperforming assets around will become meaningful from the third quarter of fiscal 2012. Together with my management team, we are committed to sustainably improving our diamond recovery and thus accreting revenue and profitability in order to close the value gap.

I'd like to thank all our listeners for your interest and for taking the time to participate in the call. A special word of thanks to Rockwell's shareholders, our directors, management, employees and other stakeholders for their committed and continued support of Rockwell's growth and development plans. I look forward to strengthening these working relationships with you as we start to unlock the underlying value of the Company.

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?

Danny Deadlock

Hi, James. Since 1998 I've published equity research from Alberta, Canada through Microcap.com and I also do the equity research for Stockup.com [?] I'm following your road map [unclear] clean up the share structure and taken quite an interest in your company [unclear] value at this level. I find that you're too small to build your share price on earnings and most [unclear] stock investors don't have the patience to hang around for years hoping for a valuation based on those earnings. Even with multiple exchange listings your stock doesn't trade very well. What efforts are you guys making for exposure, to expand exposure amongst the international [unclear] community and have you allocated these in public [unclear] communication efforts?

James Campbell

Dan, thank you very much indeed for your question. We've just completed a corporate presentation road show which started the private placement where we went to New York, Toronto, London, Cape Town and then Johannesburg. One of our executive management team, Jeffrey Brenner, is in fact based in Toronto and represents management's side from time to time. We also have our chairman, David Copeland, who is based in Vancouver in Canada and Stephanie Le Clerq, our corporate development manager, and myself are fully committed to regularly going around and meeting our shareholders and potential new shareholders from time to time. We are also in the process of having a hard look at the arrangements we have with our current brokers and to see if those will continue to add value or work with others where we feel there could be greater value. But I think the underlying message is clear; from a corporate development perspective we are very committed to meeting with our shareholders and future shareholders on a regular basis.

Danny Deadlock

Okay, yeah, that helps a lot actually. I mean you're, you know, you guys have a really marketable story. It's sort of a shame to see it trade the way it does but it's nice to hear that that's the approach you're taking.

James Campbell

Well, please stay in touch with us and Stephanie and I will be in touch with you as well as we put together our next set of plans for an international road show.

Danny Deadlock

Sure, thank you very much.

Operator

A reminder that if you would like to ask a question please press star and then one now. We'll just pause a moment to see if there are any further questions. Our next question comes from Allan Seccombe of Business Day. Please go ahead.

Allan Seccombe

Thank you. Hi, James. Just a quick one on the continuous operations. What is the current working situation and are you planning a seven-days-a-week kind of scheme from here on out?

James Campbell

Allan, thank you for your question. We have a seven-days-a-week continuous operation approval granted for our Tirisano mine which is part of Rockwell's North-West Etruscan operations going forward. We have made an application to the DMR for the same continuous operation for our Klipdam and Saxendrift properties. We're still in discussions with them at the moment, along with the NUM. Currently we're operating on a standard five-and-a-half-day shift basis, which is a three-shift per day system for five days a week.

Allan Seccombe

What kind of feedback have you had from the unions, because in my understanding it is quite difficult to get continuous operations passed by the unions, especially at an existing mine?

James Campbell

Could I ask our Group HR and IR manager who could probably give a slightly more informed answer to that? Richard.

Richard Mhlontlo

Thank you very much. We've engaged the union for about six months in 2010. We've exhausted all avenues. The matter was referred to the CCMA. The union ended up walking out at the last session and the commissioner concluded the process and after that he [unclear] our application to the DMR. Unfortunately the DMR [unclear] application [unclear] still following up with the DMR on that particular matter.

Allan Seccombe

Do you any kind of time frame of when you have to implement con-ops at those two mines?

Richard Mhlontlo

We're looking at getting an agreement towards the end of the year so that we can start implementation early 2012 but I'm speculating at the moment. It's still a long way to go which involves the office of the Premier in the Northern Cape in this particular process, hence we've copied the Minister of Mining in our discussion with the principal inspector based in the Kimberley office.

Allan Seccombe

Thank you. If I may ask another, the State Diamond Trader, what is your relationship with the STD?

James Campbell

We've got a very good relationship, Allan, with the State Diamond Trader and in fact you might be aware that 80% of our product is actually beneficiated locally here in South Africa, so we far exceed any kind of beneficiation requirements from the State Diamond Trader and others, and that's beneficiated at Steinmetz' factory in downtown Johannesburg.

Allan Seccombe

You must be one of the very few companies that have a successful relationship with STD then.

James Campbell

I can't comment for others, but I definitely know our relationship is very good.

Allan Seccombe

Okay. Thank you very much, guys.

James Campbell

Allan, just to go back and add on to what Richard said and to give you an answer there is that one of the things we highlighted in our letter to the minister and the provincial management in Kimberly was the increase in jobs we can of course have if we went to a continuous operation, aside from the profitability issue concerning Rockwell.

Allan Seccombe

Could you give me a sense of what that job situation would be?

James Campbell

I think from memory it would be an additional 81 jobs.

Allan Seccombe

Brilliant. Thank you very much.

James Campbell

Thank you

Operator

Ladies and gentlemen, as we have no further questions I would like to close the conference. On behalf of Rockwell Diamonds, thank you very much for joining us. You may now disconnect your lines.