



Transcript of the speech by ALROSA President Andrey Zharkov

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First of all, let me extend my gratitude to the Israel Diamond Exchange and personally to Mr. Shmuel Schnitzer and the Israel Diamond Manufacturers Association and personally to Mr. Kobi Korn for the excellent organization of this year's meeting, warm welcome and the opportunity to address this forum of diamond industry leaders.

As the new president of ALROSA I would like to express some views on the current state of the diamond market and elaborate on the common challenges that we face together as an industry.

The first challenge we face as a mining company is in costs of production and rough diamond pricing predictability. Our mineral resources base is limited. The majority of world's diamond deposits were discovered in the previous century. Last decade saw no new discoveries comparable to the Udachnaya and the Mir pipes in Russia or Jwaneng in Botswana. For diamond mining companies, including ALROSA, it means the necessity to focus our production efforts on prospecting and exploration, search for new technologies of cost-effective production of the low-grade deposits as well as investment in underground mining.

ALROSA has just completed a large-scale program of building three underground mines in Yakutia - the Mir, the Aikhal and the Udachnaya pipes. Underground mining required huge investments - about \$1 bln for one underground facility. Today around 25% of ALROSA's carats output is produced by underground mines. We expect this share to rise up to 35% by 2020.

Development of new projects is also underway. In the end of 2014 - first half of 2015 ALROSA started mining at two new previously explored pipes - Botuobinskaya in Yakutia and Karpinskogo-1 in the Arkhangelsk Region.

Geological exploration is another task in supporting the production and continues to be ALROSA's priority. We invested around 200 million dollars in geological exploration last year and will continue to do so in 2015. Most of our efforts are concentrated in Russia, but we also see the potential to be unlocked in Southern African countries. Our experts believe that the discovery of new large kimberlite pipes in Angola is highly probable. We anticipate that our technologies of searching for buried deposits, which have been successfully applied in Yakutia and never used in Africa before, will help us to attain our goals.

Today ALROSA, having accumulated a considerable resource base and having made material investments in its development, has set a strategic goal of bringing its annual production to over 41 mln carats, beginning from 2019.

Bringing into production its underground mines will enable ALROSA to maintain stable output in Yakutia at 36 mln carats a year. The role of the main growth driver will be played by the Arkhangelsk Region, Russia's new diamond province. This year the Lomonosov diamond field (Severalmaz division) will produce some 2 mln carats. After reaching its full capacity it will account for approximately 13% of ALROSA production - around 5 mln carats a year.



Nevertheless, the gradual depletion of current deposits will cause the start of decrease of rough diamond supply within the next 5 years while the demand is projected to continue its growth by an average of 2-5% per year in the medium to long-term period. According to the forecasts, starting from 2019 rough diamond demand will start to significantly outpace the supply.

The growing imbalance between supply and demand for diamonds could become the key market factor. Of course, we should not forget about the synthetics issue, which we believe has already started to affect the market. Thus we aim to bring security to the rough supply and therefore need to spend on our investment programs and seek acceptable level of rough prices. I should note that despite all the difficulties we face today, the rough diamond market manages to remain stable in comparison with such commodity markets as gold (-31% drop in price index during the last two years), oil (-41%) and iron ore (-61%).

The fundamental market factor of keeping the targeted balance between the supply and demand underpins our sales strategy that goes hand-in-hand with the described production and exploration plans. ALROSA's main goals envisage stable volumes of rough diamond supply and price predictability. Our expertise in mining and investments that we have made have secured the supply issue for our company and for you. Now we have to secure the sales part. But it is clear, that it depends not only on us.

Since 2009, the core of our sales system is based on long-term contracts with the industry's leading companies - largest diamond and jewellery manufacturers. Currently, ALROSA sells around 70% of its rough under such contracts, and our partners are 48 companies from all over the Globe. Together with ALROSA they form a system of responsible business practices called ALROSA ALLIANCE. These steps are aimed at maintaining our production and securing a more predictable rough diamond market.

The reason for me and my colleagues to come to Israel today was not only to take part in this respectful event, but to have an opportunity to talk and to listen to our customers. In the market situation we have today, it is very important to be in dialogue with the customers and to make adjustments of our sales instruments.

Despite the challenges at the begging of the diamond pipeline we see a balanced situation on the diamond jewellery market. In 2014 the global sales of diamond jewellery increased by some 2%. Not much but the growth on major diamond consumption markets is there. The United States, the traditional diamond market, showed stable demand growth. China and India, despite certain slowdown in growth, still can be the main market drivers mostly due to the growing middle class - the primary consumer of diamond jewellery.

Long-term forecasts indicate that we can expect diamond jewellery sales to show a sustainable growth rate of middle single digit number till 2025.

These global fundamentals could give us confidence in the future. Nevertheless, there are few things that could easily destroy all these forecasts. Synthetics, which can become a problem. Underperformance in the diamond cutting and polishing business that can potentially disturb the future growth of the whole industry. Here we must come together and find common ways of overcoming the rough-to-polished price imbalance.

As I have already noted, we had a meeting with our customers and there received a message that we should be more careful with distribution of our goods with the help of strong market players. The main problem is that the market of polished diamonds is oversupplied.



This is how come to another major challenge our industry has to face - the marketing of diamonds.

The key issue, as we see it, is maintaining consumer confidence in a diamond as an emotional symbol. During the past decade we witnessed absence of large scale category promotion and major transformation of communication patterns. Consequently diamond has been losing its symbolic value and eventually became simply one of many competitors on the luxury market.

To secure the future for our industry we need to find ways or reinstating diamond as a unique, one-of-a-kind symbolic brand positioned above the general luxury market. Diamond is not just a luxury good, it has its own special emotional meaning, which cannot be substituted with any other jewellery or fancy item. Diamond can't compete with iPhone, exotic travel and beauty industry. If the diamond is not the one and only, it will lose the battle for the consumer.

Our future is in the hands and emotions of the coming generation of millennials. They enter a phase of self-sufficiency and start to play a significant role in the global consumption. Younger people still associate diamond jewellery with love and value. But they start to think what to choose: diamond jewellery, designed lifestyle brand, new device or just travel to exotic places. It means that now for them there is less symbolism in diamond that makes it special. Moreover they want to see a positive story behind their purchases, understand the source and the integrity of the product they are buying.

If diamonds can be reinstated as one-of-the-kind emotional symbol, there is a significant potential for our industry. ALROSA shares this view with other major diamond miners and is strongly committed to finding ways of addressing the need for a diamond category promotion.

One industry player or sector cannot solve this challenge; it needs a combined effort from all of us. Miners and retailers, diamond manufacturers and dealers, have different marketing programs aimed at promoting our product. Retailers mostly concentrate on specific brand promotion, positioning of a company on the market. But what we all need is category promotion of a diamond itself, not just different brands that deal with it. The cost of diamond itself in the cost of branded jewellery is decreasing. It means that brands are earning more and diamonds are earning less.

Today we see first steps being taken on this long journey towards restoring diamond symbolism.

As you all know, seven diamond mining companies agreed to establish a Diamond Producers Association, the first ever international representative organization of its kind. This is a major breakthrough for our industry in recent years. Maintaining and enhancing consumer demand for and confidence in diamonds including joint category marketing initiatives is the main objective of the DPA. We seek to create a viable platform for a collective effort to bring the uniqueness of a diamond back on track.

Of course diamond producers cannot do this job alone, but we can lead it. And DPA should play the key role in this. We hope that this initiative will find true support from other diamond industry organisations, and WFDB together with IDMA will joint efforts with DPA to achieve our common goals in keeping the diamond symbolism and human emotions associated with it alive for the good of the whole industry.



Major diamond trading centers also have their important part to play. And ALROSA will continue to foster close relations with all of them not only within the DPA project but also on a bilateral basis to find common ground for mutually beneficial cooperation. Being here in Tel-Aviv, I'm proud to say that Israel is the third largest buyer of ALROSA's rough diamonds. Only in the beginning of this year we signed an MoU with the Israel Diamond Exchange and plan to strengthen our ties in addressing such matters as consumer confidence, synthetics disclosure, research and technologies. We hope that our long-standing relations will continue to progress and contribute to the Israel's positioning as one of the major diamond trading and cutting centers in the world.

In the end, I just want to say I am a newcomer for the diamond industry, but I have already become the part of it. I am 42 and I feel I have enough energy, patience and whatever else is needed to struggle for the industry, for the company I represent. There are more than 40,000 workers of ALROSA living and working in far regions of Russia and doing their best to bring diamonds to life, letting them to be traded in Israel, India, Belgium, and other diamond centres. Hard work of these people let us men to make our wives, daughters and mothers happy receiving these unforgettable presents.

Sorry if my speech seems to be too emotional. It is not only because of myself, but also because of the diamond's nature.

Thank you for your attention.