



Diamonds Post-Lehman Have No Aura as Buffett Can't See Recovery

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By Alan Katz, Subramaniam Sharma and Peter Robison



Sept. 15 (Bloomberg) -- A wooden swing hangs from a motorcycle chain on a porch in western India where Vilas Khoyani rocks her 7-month-old son, born eight days after her husband committed suicide. How they ended up in this two-room house starts with an unsold bag of diamond jewelry in Phoenix.

Gadi Giladi was visiting stores in Arizona on Sept. 15, 2008, the day Lehman Brothers Holdings Inc. filed for bankruptcy. The salesman was sent away by jewelers who stopped buying as they watched television news of the unfolding crisis that wiped out more than four years of **diamond price** gains.

"They wouldn't even let me open my bag," said Giladi, who was carrying bracelets, earrings, pendants and rings priced from \$200 to \$4,000, many made

with tiny diamonds of the type polished in India. "Every store, they were watching CNN, and they'd say, 'Oh my God, what's going to happen next?'"

What Giladi saw in Phoenix that day, diamond polisher Mahesh Khoyani wouldn't feel for two months: an economic tsunami set off by Lehman's collapse that drove down Christmas sales by more than 20 percent at U.S. jewelry counters, halved imports of uncut gems by traders in Antwerp, Belgium, who could no longer get credit, washed away the livelihoods of **400,000** diamond workers in India and shut mines in Botswana.

No Recovery

The industry -- which employs more than 1 million people from Jwaneng, Botswana, to Surat, India, to New York's diamond district -- faces two more years of turmoil, and prices may not return to pre-crisis levels for at least a decade, said **Richard Platt**, managing director of **WWW Diamond Forecasts Ltd.** in Eastbourne, England.

Platt, who created pricing scenarios when he worked at Johannesburg-based De Beers Group, the world's largest diamond supplier, said prices for rough stones, up 40 percent since March, are "unjustified by retail sales" and will probably fall over the next 12 months. Polished prices will stagnate after a 4 percent rise, he said.

That means more hardship in the jewelry business in the U.S., where **sales** have fallen every month this year through June and aren't expected to recover anytime soon; in Botswana, which is bracing for a 50 percent drop in diamond revenue in 2009; and in India, where 240,000 polishers and cutters may not be able to return to work for at least 18 months after the recession ends, according to **Vasant Mehta**, chairman of the **Gem & Jewellery Export Promotion Council** in Mumbai.

"We relied on diamonds, and they betrayed us," Vilas Khoyani said, staring into space outside her parents' home in Sanathali, 814 kilometers (506 miles) north of Mumbai, where she lives with her two sons, Diviesh and 4-year-old Tushar.

'Unhappy Goose'

Like housing in the U.S., diamonds spawned a bubble in which easy-to-obtain credit made buyers willing to pay higher prices and created a false sense that these polished rocks were perpetually rising stores of value, said **Christopher Ellis**, president of **Consensus Advisory Services LLC**, a Boston investment bank that advises companies on restructuring.

Prices rose 38 percent from the end of 2003 through mid-2008, buoyed by growing U.S. household wealth, which peaked at \$64.3 trillion in the third quarter of 2007. Rough stones rose 81 percent over the same period, said Platt. About half of the world's polished diamonds are sold in the U.S., according to De Beers.

"It is possible to pull too many diamonds out of the ground and cut and polish too many of them and try to cram them down the gullets of the American customer," Ellis said. "It's like making foie gras. You wind up with a very unhappy goose."

Rough Stones

The aftermath of Lehman's crash laid bare how the credit glut pumped up valuations of the billion-year-old sparkling gems. In the six months following the bank's collapse, as credit markets froze, prices for rough stones **fell** 40 percent and those for polished gems slumped 19 percent, according to data from WWW Diamond Forecasts and PolishedPrices.com, which provides pricing information.

Everyone along the supply chain had bought into the bubble, including Mahesh Khoyani, who dropped out of school after the fifth grade and was 29 when he died. He took out a loan last October, as disaster curled his way, to finance construction of a 400,000 rupee (\$8,206) two-bedroom house for his growing family in his ancestral village near **Rajkot**, a city of 1 million in the western state of **Gujarat**.

'Cannot Be Real'

That same month in Belgium, which handles about 80 percent of the **global trade** in uncut diamonds, the **Antwerp World Diamond Centre** (AWDC), a trade association, canceled a conference and dinner scheduled for November featuring Virgin Group Ltd. Chairman **Richard Branson**. On Oct. 28, **Dirk De Nys**, a senior buyer for **IGC Group NV**, which cuts, polishes and resells diamonds, cursed into his mobile phone when a colleague told him of a 35 percent plunge in auction prices for rough stones.

"We should just go home," said De Nys, 45, as he read the list of prices faxed to his hotel room in Shanghai, where he had gone to hire a diamond-cutting company. "This cannot be real."

It was real. Imports of rough diamonds to Antwerp **fell** 50 percent from October through August in dollar terms compared with the same period a year earlier, according to data from the AWDC.

The value of polished stones **shipped** from India, where 11 of every 12 diamonds sold in the world are cut and polished, tumbled 59 percent in November from the month before, according to the gem council in Mumbai.

That was devastating for Mahesh Khoyani, a diamond polisher since the age of 15, whose pay had jumped by 50 percent to 12,000 rupees in October with overtime. His factory in **Surat**, a city that is home to more than half of India's 710,000 diamond workers, closed on Oct. 28 for Diwali, the Hindu festival of lights. It never reopened.

Jwaneng Mine

By late December, the wave had rolled back to the source, in Botswana, where Goitseone Kgosi, 26, a contracted equipment repairman, lost his job at the **Jwaneng** diamond mine, the richest in the world. The pit, run jointly by **De Beers** and the government of the southern African nation, shut for four months.

"They told us that Americans weren't buying diamonds," Kgosi said in July, as chickens and dogs roamed around him on a dusty sidewalk in Jwaneng. "I had to move out of the room I rented. I didn't have money for food."

Diamonds, among the world's hardest natural substances, proved unable to withstand the pressure from the worst recession since World War II. Global diamond jewelry sales are down as much as 10 percent this year, after expanding to about \$73 billion in 2007 and running at a similar pace in 2008 before the slump began in October, according to **Russell Shor**, senior industry analyst at the Carlsbad, **California-based Gemological Institute of America**.

Fortunoff, Whitehall

Decades-old U.S. chains including Fortunoff Holdings LLC, founded in Brooklyn in 1922, and Whitehall Jewelers Holdings Inc. of Chicago, started in 1895, have sought bankruptcy protection. Irving, Texas-based **Zale Corp.**, whose shares have dropped 73 percent since Sept. 16 last year, said it shut 118 stores in the quarter ended in July, bringing the number of closures in the first seven months of this year to 191.

In all, 1,261 U.S. jewelry stores, wholesalers and manufacturers folded from January through July, a 53 percent jump from a year earlier, according to Dione Kenyon, president of the Warwick, Rhode Island-based **Jewelers Board of Trade**, which rates the creditworthiness of businesses in the industry. The total this year is expected to be about 3,000, Kenyon said.

Buffett's Bling

Jon Bridge, whose family has sold jewelry in Seattle for 97 years, said he grew so accustomed to rising sales that he faced more crises on the boards of charities. That changed in October, as the co-chief executive officer of **Ben Bridge Jeweler** choked down dinner in his home office and pored over reports showing a 20 percent decrease in sales, the

most he had seen.

"This wasn't just a bubble, this was a balloon, a hot-air- balloon explosion," said Bridge, a great-grandson of the founder of the 75-store chain, owned since 2000 by [Warren Buffett's Berkshire Hathaway Inc.](#)

Bridge blamed easy credit and inflated incomes for exacerbating the bust.

"We were living a fairy tale for the last 10 years or so, and you can't do that," Bridge said.

The chain has closed three stores in the past year. Buffett's other jewelry-store company, North Kansas City, Missouri-based [Helzberg Diamonds Shops Inc.](#), has shut 19 stores this year, reducing its total to 233.

Buffett, 79, told Bridge employees not to expect a quick recovery. The billionaire investor, who receives a mailed copy of Ben Bridge's weekly sales, met Bridge and other executives for lunch in May at Chandler's Crabhouse on Lake Union, north of downtown Seattle.

"We are deeply in this -- in a recession -- and it's going to take a long time to get out of it," Buffett said over his usual meal of steak and a cherry-flavored Coke, according to Bridge. Buffett didn't respond to e-mailed questions.

1-Carat Spike

Asking prices for diamonds of 1-carat or more shot up in late 2007, according to data from the Rapaport Group, a New York-based provider of diamond prices, as investors moved into commodities ranging from soybeans to oil. The trend heightened in early 2008, amid signs the subprime-mortgage crisis in the U.S. was broadening with the forced sale of Bear Stearns Cos. to JPMorgan Chase & Co. [De Beers](#) lifted the price of its diamonds by 16 percent in the first half of last year, generating a 10 percent increase in revenue to \$3.74 billion.

By mid-2008, traders were flipping loose stones back and forth like Florida condominiums, said [Stan Grossbard](#), president of RCDC Corp., a diamond seller located on a block of West 47th Street with gem-shaped street lights that is New York's [diamond district](#).

Florida Retirees

More than 90 percent of diamonds entering the U.S. pass through New York, mostly through [this block](#), according to the 47th Street Business Improvement District, a nonprofit group. The gems, folded in parcels of white paper, are graded, cut and traded behind steel security doors, then sent to retailers around the country. Some 2,600 businesses crowd into the area's pavilions and exchanges, many of which trace their roots to the 1940s, when Orthodox Jews in the trade fled Europe.

Grossbard said he was stunned when a broker came into his office in August 2008 asking \$700,000 for a 7-carat radiant-cut diamond. Twenty-five years ago, he said, a similar diamond might have cost one-tenth of that.

"Do you realize how many retirees are on South Beach walking around with \$700,000 on their fingers?" Grossbard said he asked the dealer.

Lehman's downfall dealt the industry a double whammy: First, it sparked a run on the \$3.6 trillion money market industry, which provides short-term loans called commercial paper used by businesses worldwide to cover everyday expenses. That led banks to stop extending credit in general, hurting jewelry stores and diamond wholesalers worldwide.

Conversation in Kathmandu

The demise of what was once Wall Street's fourth-largest investment bank also wrecked the wealth of baby boomers who accounted for 40 percent of U.S. jewelry sales, according to [Nick White](#), a former chief operating officer at Zale.

"They've lost a ton of money in the market," said White, now an independent consultant and custom jeweler in Beaver Dam, Kentucky. "They're not going to be buying that really big stone for the 50th wedding anniversary."

For Giladi, 54, a West Coast sales executive for jewelry maker [Oro Alexander Inc.](#) in Encino, California, the Lehman hit to his business came in real time. Unable to sell anything, he cut his trip short.

Four months later, 10 stores on his sales route had closed, said Giladi, who grew up on a farm near Tel Aviv and got his start in the jewelry business in 1989 after a chance conversation while vacationing in Kathmandu, Nepal. More of his customers are likely to disappear if sales don't rebound by December, Giladi said. Many have already seen their credit rating plummet, meaning they might not be able to pay.

Antwerp Diamantaires

"Right now, it's dangerous to sell," he said.

With reduced commissions, Giladi's income will be down as much as 70 percent this year, he estimated. In March, he

sold a cabin he owned in Big Bear, California, a ski area two hours east of Los Angeles by car, as he prepared for an earnings slump he expects to last three years.

The shock waves rolled across the Atlantic Ocean to hit Antwerp's cutters and traders, also known as diamantaires, in October. Trading houses in Antwerp, which became Europe's diamond-cutting center in the **15th century**, sell to buyers including Tiffany & Co. and Cartier.

De Nys called a company meeting after seeing the fax showing a plunge in prices for rough stones at an Oct. 23 auction by BHP Billiton Plc. That was the same day former Federal Reserve Chairman **Alan Greenspan** said a "once-in-a-century credit tsunami" had engulfed financial markets.

Memo System

The firm's executive committee met on Nov. 3 in IGC's Antwerp office, seven floors above the practically deserted **Antwerpsche Diamantkring** exchange, which has 6-meter-high (20-foot) windows and parquet flooring laid in the shape of a diamond. They decided to stop almost all purchases of rough stones and to cut, polish and sell those in stock in IGC's factories in Laos, Thailand and Botswana.

The company also slashed its payroll to 900 from about 1,500, De Nys, who joined IGC 22 years ago, said in an Aug. 26 interview. Outside his building on Hoveniersstraat, Antwerp's main diamond thoroughfare, groups of Indian men dressed in dark suits and bearded Orthodox Jews in hats and long coats huddled in conversations.

Fiddling with a box of 1-carat uncut gems in his office, De Nys said IGC had shelved a May plan to bring its factories up to 70 percent capacity by this month from 50 percent. He doesn't see any rebound in polished diamond prices or demand.

'Credit Pig'

October's price dive was exacerbated for traders because they had become creditors for their customers, said **Martin Rapaport**, founder and chairman of the **Rapaport Group**. Stones were often sent to clients under a so-called memo system that allowed retailers and wholesalers to increase their stocks even if they didn't have the cash to buy the gems outright, Rapaport said.

The practice mushroomed over the past decade as traders enticed customers to boost their own volumes to profit from rising prices, he said. In recent bankruptcies, chains had as much as 25 percent of their inventory on memo, according to Consensus's Ellis.

"We took a cash cow and turned it into a **credit pig**," Rapaport told dealers packed into a ballroom at the Venetian **Las Vegas** for a jewelry trade show on June 1.

Diwali in Surat

Nobody can afford the old inventory-based system, said Rob Broedelet, head of ABN Amro Bank NV's international diamond and jewelry group for the Americas. This year, credit to the industry is down 20 percent to 30 percent and people may be shifting to a just-in-time manufacturing and purchasing system, he said.

"It's going to be potentially a major change," Broedelet said.

The ripples had scarcely been felt in Surat when many of the city's 400,000 diamond polishers headed home for Diwali, the most important holiday for Hindus, who make up 80.5 percent of India's **population**.

Khoyani took a bus 420 kilometers northwest to the village of **Jasdan** to make a 150,000-rupee down payment on his house.

"He was talking about saving more money, taking loans and paying for it before our second child was born," his widow, Vilas, said in a July interview in heat of 38 degrees Celsius (100 degrees Fahrenheit). "We could never afford to buy a house in **Surat**."

Bollywood Music

The city of 2.9 million people on the banks of the Tapti River has been a diamond transit point since the 1600s. During the past decade, the number of three- and four-story workshops in Surat's narrow lanes swelled, packing the streets with gem traders and porters bearing plastic cups of sugary tea while Bollywood music blared from the buildings.

Surat was quieter when Khoyani returned in mid-November. He was told his factory would remain closed for several more weeks. He went to see Laxman Dhola, who operated a workshop with four scaifes, or rotating wheels that resemble record turntables and are used to polish diamonds.

Dhola paid 20 rupees for each rough diamond polished, said Praful Porsia, 21, who worked alongside Khoyani. Polishers would get about 10 stones a day to turn into tiny 0.05-carat gems for the types of bangles and necklaces sold by Giladi.

Diamond Dust

Inside Dhola's fourth-floor shop, Khoyani would squat beneath a fluorescent light on the dirt-encrusted floor. He would place a rough stone, mounted on a holder called a dop, on a scaife covered with oil and diamond dust.

He didn't talk much, Porsia said, other than to ask for more work.

"He would keep telling Dhola to give him more stones to polish," Porsia said. "He needed the money to pay for his house."

Instead, the work disappeared.

As exports of polished diamonds from India plunged, more than 160 members of the council for the gem and jewelry industry ascended a marble staircase to a banquet hall at the Karma Liquid Lounge restaurant in Mumbai on Nov. 14. They decided to appeal to all diamond traders to stop importing rough stones for a month, according to **Sabyasachi Ray**, the council's executive director. The move was unprecedented, said Mehta, the group's chairman.

Imports of rough diamonds in December fell 91 percent from the same month the previous year, to \$85.8 million, based on council **data**.

Swallowed Pesticide

There were days when Khoyani wouldn't polish a single stone, Porsia said. He fell behind in his payments to the builder and to an uncle, who loaned him 50,000 rupees, said Dinesh Ruparalia, Vilas's brother and a former diamond polisher.

On the morning of Dec. 28, Khoyani left home in Surat to pick up a newspaper. Instead, he swallowed pesticide. He collapsed in his wife's arms on his return, Vilas said. He was dead when they got to a hospital at 10 a.m.

"He was scared after hearing about the slowdown, but I had no inkling he had lost all hope," the widow said, speaking in Gujarati as her mother poured milky tea from a kettle into stainless-steel saucers.

At least 16 diamond polishers killed themselves between Oct. 11 and March 20, said K.M. Patel, assistant **labor commissioner** in Surat, citing a report compiled by the local government. Some 413,780 of India's 710,950 diamond workers lost their jobs, according to a Feb. 26 **report** by the Reserve Bank of India, the central bank. Almost half of those were in Surat.

Dhola shut his factory in April, said Porsia, who now works in a shop on the first floor of the same building. Dhola couldn't be located.

Botswana Mines

It was December when Kgosi lost his job and Botswana's economy went into a nosedive. More than 5,200 miners were told to lay down their tools at the open-pit Jwaneng mine, which produced 15.6 million carats in 2006, and three other mines.

Unlike the miners, who continued to receive their salaries, Kgosi, a contract worker for Mechanical Construction Botswana, which repairs equipment, lost his monthly paycheck of 1,500 pula (\$226).

"The general manager and foreman spoke to us," Kgosi said. "They said they didn't have money to pay us."

Diamonds were discovered at Jwaneng in 1972. The mine, run by a joint venture called **Debswana Diamond Co.**, opened a decade later. It is now 300 meters (984 feet) deep and about 2.5 kilometers long. It and the three other Debswana mines that were closed accounted for 20 percent of the world's diamonds by volume last year, according to the **Kimberley Process**, a global body that certifies diamonds and restricts the sale of illicit gems.

'It Was Hard'

Kgosi couldn't afford the 250 pula-a-month rent for a room in a house in Jwaneng, a town of 17,000 dotted with open-air bars, where people drink Chibuku, the local sorghum beer, beneath trees that line the roads. So he went back to his native village of Serowe, 400 kilometers to the northeast, to herd cattle.

"It was hard," Kgosi said. "I went to my sister for help. She gave me money for food."

He got his job back in March, before the April 15 opening of the mine. Even with three of Debswana's mines back in operation, the company said on Sept. 8 that it may produce only 17 million carats this year, about half the 32 million mined in 2008 and the least since 1994.

'Not Forever'

Botswana's economy contracted 20.3 percent in the first quarter from a year earlier, largely because of the closure of the mines, which account for half of the government's revenue, **official data** show. The country posted its first budget

deficit in five years in the fiscal year that ended in March. That will widen to a record 14 percent of gross domestic product in the current year, according to official estimates.

The government was forced to turn in June to the [African Development Bank](#) for a \$1.5 billion loan, the first time in 17 years it sought credit from the lender. It also cut public spending by 6 percent.

Botswana's economy will probably shrink 6 percent this year and may experience several years of "subdued growth," said [Razia Khan](#), head of Africa economic research at Standard Chartered Plc in London.

"There is a growing realization that the government won't be able to spend at the levels it has," said Khan, who grew up in Botswana. "Everyone knows that diamonds are not forever."

'New Reality'

De Beers, the 121-year-old company that marketed its gems as a sparkling measure of love with the tagline, "A Diamond Is Forever," slashed production by 91 percent in the first quarter of 2009, cut 23 percent of its workforce, or 4,700 people, and borrowed \$500 million from shareholders, including [Anglo American Plc](#), which owns 45 percent of De Beers.

The way of doing business for diamond buyers and industry workers has ended and isn't coming back, according to Rapaport.

"Friends, it's not going to get better," he told jewelers and traders at the Las Vegas trade show. "This is not a crisis, it's a new reality. It's not just about money. It's a shift in social values."

That view is shared by [Johann Rupert](#), chairman of Geneva-based [Cie. Financiere Richemont SA](#), the owner of Cartier and Van Cleef & Arpels. The company reported a 16 percent decline in five-month revenue on Sept. 9.

"People are reluctant to be seen purchasing luxury goods," Rupert said. "Previously we relied on the feel-good factor. Now even people with the money have the feel-guilty factor stopping them from buying."

Vacation in Mongolia

For salesman Giladi, business was so slow in July he took the month off and went to Mongolia, spending \$3.50 a night to stay with families in their tents in the countryside. The trip inspired him.

"We need to trim down, not spend too much and be very careful," he said.

Vilas Khoyani is already doing that. She left Surat at the end of January and took her two children back to the village where her parents live. She canceled the house her husband had ordered, leaving her with 100,000 rupees to subsist on.

"The money is not going to last for long," Vilas said as she held out a photograph of her husband taken on their wedding day. "I just want to live my life with dignity."

To contact the reporters on this story: [Alan Katz](#) in Paris at akatz5@bloomberg.net; [Subramaniam Sharma](#) in New Delhi at ssharma@bloomberg.net; [Peter Robison](#) in Seattle at robison@bloomberg.net.

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