

Diamond Exports Set to Hit 5-Year Low in FY24; Profits Suffer as Prices Fall

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Synopsis

- India is the world's largest centre for cutting and polishing diamonds, accounting for over 90 to 95% of the total world's polished diamond consumption. The US and China, the primary diamond-consuming markets, together account for approximately 65% of India's diamond exports. Following the pandemic, a surge in diamond jewellery demand, spurred by the US economic stimulus and limited opportunities for experiential spending, propelled Cut and Polished Diamond (CPD) exports to record highs in FY22 (\$24.43 bn) and FY23 (\$22.04 bn).
- However, a decline in CPD demand began in December 2022. Despite expectations of a recovery during the holiday season of H2FY24, factors such as the economic conditions in the US and China, the rise of alternative discretionary spending options, the growing market for Lab-grown Diamonds (LGD), and geopolitical tensions have negatively affected India's CPD exports. This resulted in a 28% year-on-year drop to \$13.04 billion in 10MFY24, driven by decreases in volume and value.
- The demand-supply imbalance has pressured the pricing of polished diamonds, leading to a price correction estimated at 5%-10% for diamonds below 0.3 carats, 20%-30% for 0.3-3 carat diamonds, and 10%-20% for diamonds above 3 carats in CY23. This imbalance and price correction have adversely affected the export value.
- High inventory levels at the start of FY24 and subsequent fall in prices of CPD have impacted the scale and profit margins of CareEdge Ratings-rated entities, resulting in higher than anticipated decline in Total Operating Income (TOI), profitability and Gross Cash Accruals (GCA).
- Thus, the outlook of the CPD industry is negative. CareEdge Ratings expects the **CPD exports to hit a five-year low during FY24 with a dip of around 25-30% to \$15 billion to \$16 billion**. Further, we do not expect a significant recovery during FY25.

Economic landscape of major CPD consuming markets

Declining consumer demand in USA: The US diamond and jewellery industry is coping with the challenges of rising inflation, the opening of alternate avenues with higher preference for experience-based spending has dampened the customer sentiment in the current fiscal year. Moreover, the increasing penetration of LGDs from engagement rings to the bridal jewellery segment has resulted in lower demand for CPD in the largest diamond jewellery market, which accounts for over 50% of the diamond jewellery demand.

Economic crisis in China: The second-largest diamond jewellery market has been facing an economic crisis since 2018, followed by its zero-tolerance policy to tackle the Covid outbreak, the collapse of the real estate market, the economic crisis, and the growing preference of its population for experience-based spending and gold jewellery. Hence, China, which accounts for 10-15% of global diamond demand continued to remain subdued even in FY24. Recovery in diamond jewellery demand requires an overall improvement in the macroeconomic conditions to change customer perspective and increase spending for discretionary products like diamond jewellery. In light of the above CareEdge Ratings expects no immediate recovery in demand for diamond jewellery from Chinese markets.

Growing acceptance of lab-grown posing additional challenges for CPD

Affordability, sustainability, and similarity are the key factors leading to a surge in demand for LGD, especially in the 1-3 carat segment of natural diamonds. With essentially the same chemical, optical and physical properties,

and crystal structure as natural diamonds, at a fraction of the price has led to a significant double-digit growth of LGDs in the USA. While the price of LGDs has plunged even more steeply than that of natural and is now selling at a bigger discount than ever before, its share in engagement rings and bridal jewellery in the overall diamond jewellery market has increased on a YoY basis. Despite the consistent dip in prices, India exported LGD of \$1.3 billion during 10MFY24; 9% of total CPD exports.

Impact of G7 regulations

On the supply front, G7 nations have announced sanctions on Russian-origin diamonds to be implemented in three phases from January 2024 to September 2024. Going forward, to ensure the traceability of diamonds for diamonds of 0.5 carats and above, a centralized, technology-based tracking system from the point of rough diamond exports in the country of origin to the store could be established. This could have compliance and supply-side challenges for Indian CPD players.

Midstream dilemma

Challenges arising from demand-supply mismatch are not an exceptional scenario for Indian entities and the same re-emerged post the Covid upturn marked by rough diamond procurement, at high prices quoted by miners. While few entities adopted a cautious approach, most bought excessive volumes. As the retail prices slumped, jewellery manufacturers/ retailers curtailed their orders after robust buying in H1FY23. This has resulted in a scenario of excess polished inventory well above pre-Covid levels amid dampened demand reversing the gains of FY21-FY22. To curb the losses and focus on liquidating inventory holding, the Indian entities self-imposed suspension of rough diamond imports for two months (October 15, 2023 - December 15, 2023). While the restricted import of rough diamonds helped streamline inventory levels to an extent, the reduction in rough diamond prices by DeBeers at its first sight for CY24 is expected to address the disparity between rough and CPD prices going forward.

Impact on the CareEdge Ratings rated portfolio

Taking cognizance of recent developments and revision in the sector outlook to negative, CareEdge Ratings has undertaken the review of 29 investment grade CPD segment entities which account for ~35% of the Indian CPD industry (based on exports of Rs.1,77,000 crore during FY23). CareEdge Ratings envisages higher than expected moderation in TOI and GCA levels and accordingly outlook for the majority of these entities was revised to negative apart from a rating downgrade in a few entities.

Outlook – Negative

- The CPD exports from India are expected to hit a five-year low in FY24 and demand in the near term is expected to remain subdued.
- In the medium term, CPD exports from India will be influenced by economic recovery in consumption markets, geopolitical landscape, and customer preference for diamond jewellery in the discretionary spending space. The entities with prudent debtors and inventory management are expected to sail the tough tide.
- The impending impact of G7 sanctions on Russian-origin diamonds regarding logistic and operational challenges for Indian CPD players would remain a key monitorable.
- Yogesh Shah, Senior Director at CareEdge Ratings says, "Players operating in smaller carat diamonds (below 0.3 carats) to be better placed than entities dealing in certified diamonds, as smaller carat diamonds have witnessed lower price erosion and limited impact of LGD diamonds".

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