

DIAMOND INSIGHT FLASH REPORT #6

◆ MARCH 2020

A Year of Change

U.S. Holiday 2020 Recap and Emergent Consumer Mindsets

Holiday Q4 Brought Good Tidings for Diamond Jewelry Retailers

While the reality of 2020 was grim, the holiday period was infused with an optimistic outlook for the new year, influenced by hopes for a new era in government, a new infusion of stimulus money, news of imminent vaccines, and the strong performance of financial markets.

Holiday retail sales reporting revealed that jewelry, particularly classic diamond jewelry, performed well in a dismal year. Throughout the fourth quarter of 2020, mass and independent fine jewelers saw strong sales, with the holiday period starting earlier than usual as customers found themselves with more time to shop thoughtfully. The overall jewelry category (which includes costume jewelry and watches) was down versus the previous year by 4.3% (with jewelry ecommerce up by 44.6%); however, diamond



jewelry retailers across the nation reported very strong performance, particularly in diamond jewelry classics. The category fared favorably compared to apparel, which was down a steep 19.1% year on year, and luxury goods (excluding jewelry), which were down 21.1% year on year.*¹ The Bain Diamond Report 2020-21 summarizes: “[D]iamond jewelry retail performed better than the personal luxury market.” And according to industry analyst Edahn Golan, “Usually, specialty jewelers’ December sales average 122% higher than in November. This year, they knocked that up to

more than 160%. Based on the sales of hundreds of specialty jewelers, December sales were up a robust 4% year over year – despite the pandemic.”*²

Consumers Take Haven in “Investment” Purchases

As noted via De Beers’ proprietary consumer tracking across the pandemic period, customers who maintained discretionary income found themselves with extra funds that normally would have been spent on experiential luxuries such as dining, entertainment and travel, or impulse luxury shopping trips that in normal times would result in apparel, cosmetic and bag “hauls.” Knowing that the global economy was volatile and uncertain and also feeling some guilt

about shopping while many suffered, consumers did continue to spend but chose to invest in fewer, better things – their indulgent purchases were also stores of value likely to appreciate over time. Fine jewelry took on a sharpened relevance in the pandemic context, leading to a surge in purchases of high-ticket classics, such as engagement ring and solitaire stud upgrades and investment-grade watches, particularly the iconic models from leading brands such as Rolex.

As Caryl Capeci, CEO of Chow Tai Fook North America, reflected on the Hearts on Fire and Memoire brands' positive holiday sales: "In times of uncertainty or a crisis like 2020, consumers often lean to those items that represent security, safety and value. Better quality, classically designed diamond jewelry fits this need perfectly – especially when connecting with those we love the most. Both Hearts on Fire and Memoire retail partners experienced this firsthand last year."

Charles Stanley, president of Forevermark US, saw similar consumer buying patterns.

Observing an uptick in one carat plus Forevermark diamond sales this holiday season, he noted "One carat plus diamond rings and diamond ear studs were the stand-out pieces that sold especially well versus prior year, as did all classic diamond jewelry. This clearly proves that the enduring value of diamonds resonated strongly with consumers, reflecting their desire to give gifts of meaning and lasting value this past holiday season."

Significantly, in the analogous territory of luxury goods the same mindset could be seen, with trend-



driven houses such as Gucci struggling with losses, while Hermés, maker of classic handbags, saw a 12.3% increase in Q4 sales*³. The brand attributed this performance – again – to classic handbag styles in gray, black, and off-white colors, with the Madison Avenue boutique recording its best year in history (accessory sales up 30% over the previous holiday season). Consumers had rational reasons for spending in the categories they chose, but psychological factors were clearly at play too – watching so many others in true financial distress, there was a need to spend in a way that felt conservatively value-conscious, rather than spending with a hedonistic, "mad money" quality.

Looking forward to the rest of 2021, in a March 2021 survey conducted by De Beers, 43% of U.S. consumers said they were more likely to make a significant purchase in 2021 than last year. The March survey also confirmed that the mindset of the majority of Americans remains firmly rooted in quality over quantity for now: 88% said they believe that nowadays it is better to invest in fewer but better things than in items which are fashionable but may not last.

The Roles of Natural Versus Lab-Grown Diamonds (LGDs), According to U.S. Consumers

In the midst of the holiday shopping season (mid-December), De Beers fielded a wave of its bi-annual LGD tracker via 360 Market Reach, with a national panel of 5,000 respondents. The study found that even as affluent consumers were purchasing high-value natural diamond jewelry, they were becoming increasingly aware of LGD jewelry. Whether affluent or non-affluent, consumers were interested in and open to LGDs. As awareness grows (with about 2/3 of fine jewelry consumers aware of the concept), it is clear that LGDs occupy distinct territory in the jewelry repertoire: LGDs are seen as new, modern, fun, and appealing for impulse or self-purchase. While 47% of consumers do not agree with the statement that LGDs are "real," consumers will still seriously consider acquiring them for the primary reasons that they are "fashionable" and cost less than natural diamonds.

As awareness of and consideration for the LGD category grows, there is lessening belief that LGDs are socially conscious or environmentally responsible,

with agreement with this statement having dropped by 8%. As LGDs mainstream, they become increasingly identified with providing "flash for cash" -- with the attribute of "fun" moving from 14% to 20% since March 2019. When asked who LGDs are for in terms of gifting, 55% of women say "myself," making them a self-purchase item in serious competition with apparel and leather goods.

Meanwhile, consumers differentiate natural diamonds by attributing to them the key category territories of "authentic" (60% vs. 6% for LGD); "romantic" (41% vs. 6% for LGD); and "would make me feel special" (37% vs. 3%).

Characteristics attributed by consumers	NATURAL	LGD
AUTHENTIC	60%	6%
ROMANTIC	41%	6%
SPECIAL	37%	3%

LGD perception:
"Not as rare"

Over the two years in which the tracker has been conducted, the top concerns in consumers' minds about LGDs have remained consistent: They are "not as rare" as natural diamonds and will not retain their value over time.

Because of these concerns (and their interaction – lack of rarity and lack of intrinsic value being clearly inter-related), 7 out of 10 consumers state that they would not pay more than \$1,000 for an LGD.

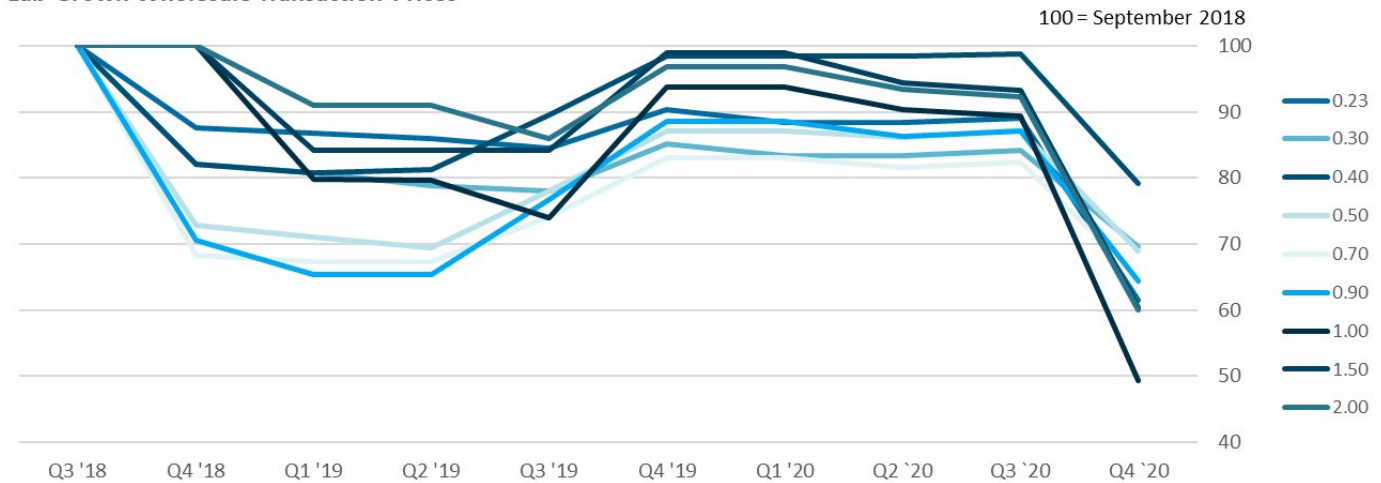
Concurrently, independent research by industry

analysts shows that LGD wholesale prices (and to a lesser extent, retail prices), are declining rapidly, validating consumer concerns about lasting intrinsic value but also opening up new possibilities for more frequent "fun"/ fashion purchases.



Consumers would not pay more than \$1,000 for an LGD

Lab-Grown Wholesale Transaction Prices



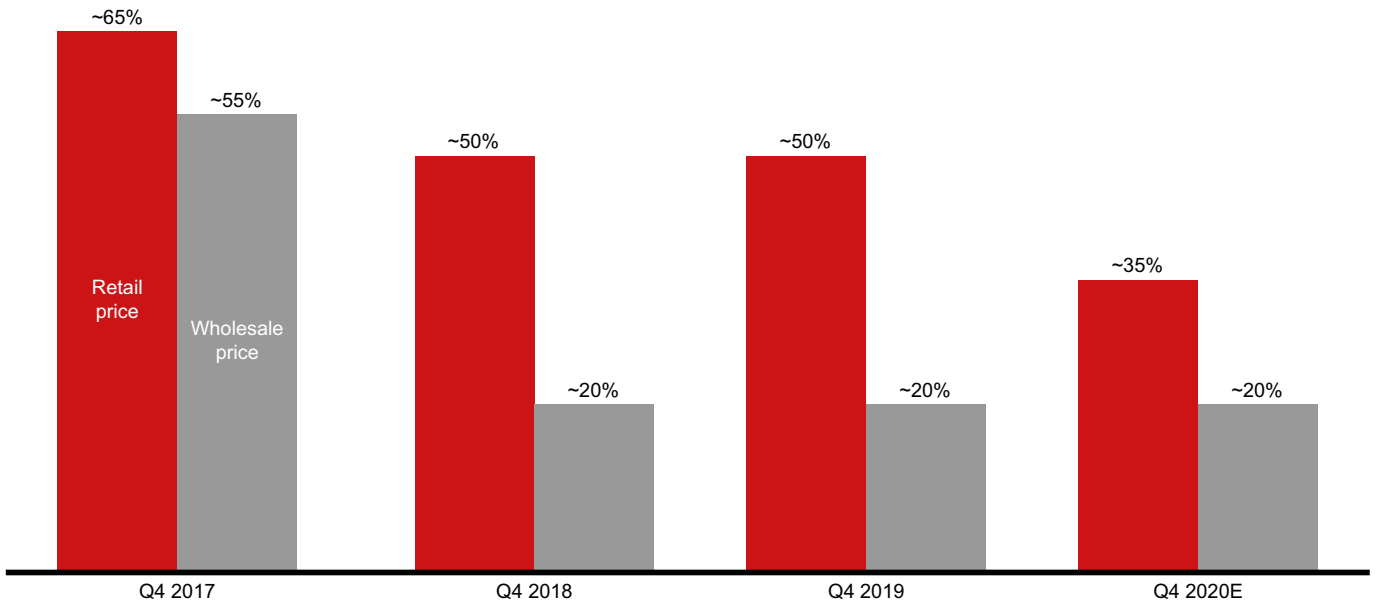
Based on average wholesale transaction prices of parceled goods
Source: Edahn Golan Diamond Research & Data Ltd

EdahnGolan.com/LabGrownPriceList.com EG

As of December 2020, based on De Beers Group Pricing Team data and corroborated by the Bain report, the LGD wholesale price discount to natural

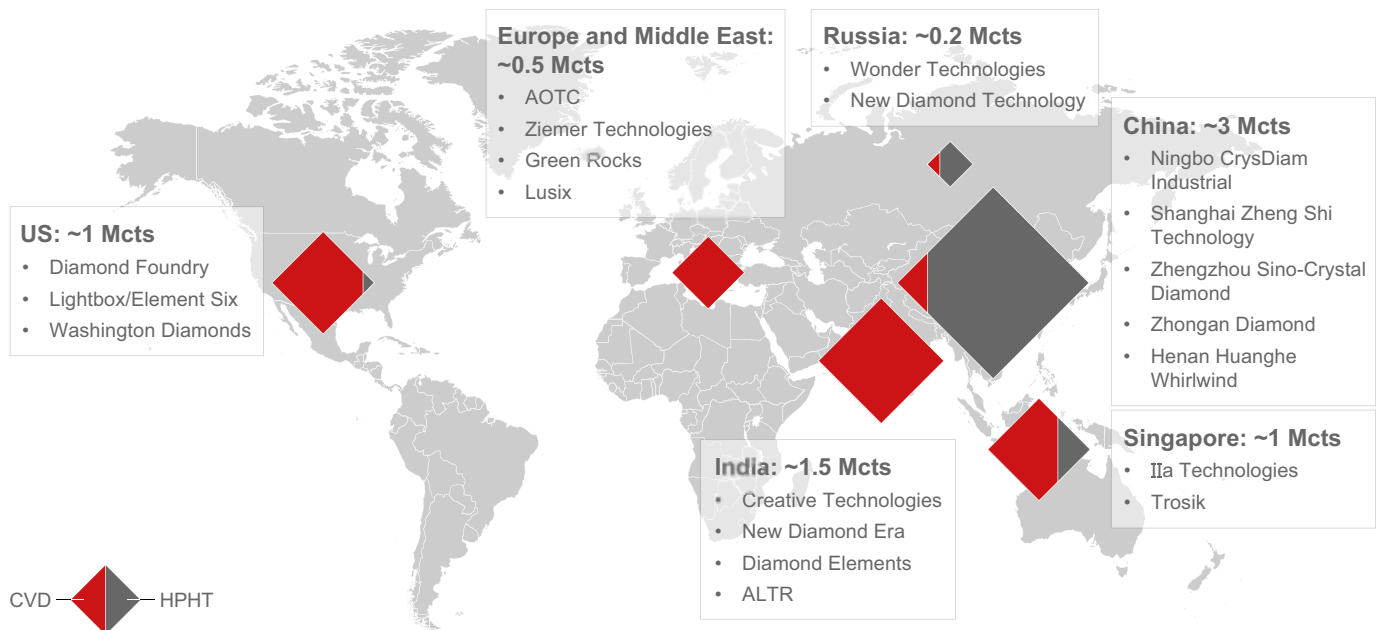
polished wholesale prices was roughly 80% (i.e. the LGD wholesale price is ~20% of the natural wholesale price of equivalent size and quality.)^{*4}

Price of polished lab-grown diamond as a percentage of polished natural diamond (1 carat G VS polished)



Notes: Values calculated with the average discount and price for the given period; G refers to gem color; VS refers to VS1 and VS2 clarity
Sources: Expert interviews; online retailers' websites; Bain & Company

Total gem-quality lab-grown diamond rough production, 2020E: ~6–7 million carats (Mcts)



Notes: CVD is chemical vapor deposition technology; HPHT is high-pressure, high-temperature technology; the list of players is not exhaustive and includes only key LGD players
Sources: Company data; publication analysis; expert interviews; Bain & Company

A March 2021 De Beers consumer survey shows that in a scenario where consumers buy LGD jewelry and the price of LGDs drops by 50%-60% over two years, while natural diamonds remain priced the same or higher (a scenario that would remain consistent with the past two years), 32% of American consumers would be less likely to trust or purchase fine jewelry from the same retailer, and a fifth (20%) would just not buy fine jewelry from the same jeweler in future. The overall negative impact of quick LGD price decline would result in more than half (52%) of customers turning away from the jewelers who sell them this product. This negative impact is strongest for women, at 58%.

Steve Coe, CEO of Lightbox Jewelry, selling LGD jewelry, notes: "We have always sold our LGDs at a fair and transparent price, derived from a reasonable commercial margin above the actual production cost, rather than hitching it to what a natural diamond's value might be. Recent LGD price falls simply indicate that we are today where others will be tomorrow. Around or below \$1,000. Exactly where the consumer wants us to be."

As industry analyst Edahn Golan observes, "In terms of dive and bounce, LGDs had it in their own unique way, behaving very differently than natural diamonds, as loose or set in jewelry."^{*1}

As LGD jewelry settles in and matures as a category and prices continue to fall steadily, it's clear from consumer attitudes and behavior that natural diamonds and LGDs offer differing benefits. Consumers with disposable income voted with their wallets this holiday season, recognizing that natural diamonds provide a secure and lasting store of value; symbolize love and commitment; and feel like a true luxury. As they enter 2021 hopeful to be able enjoy public life and culture once again, the difficult year behind will likely have fine-tuned their sense of what types of material goods and temporal pleasures feel worth spending on to create a sense of value, control and quality for money in their lives.

^{*1} Source: Mastercard Spending Pulse
<https://www.mastercard.com/news/press/2020/december/mastercard-spendingpulse-u-s-retail-sales-grew-3-this-holiday-season/>

^{*2} <https://www.edahngolan.com/dive-and-bounce-the-golan-diamond-market-report-q4-2020>

^{*3} Source: <https://nypost.com/2021/02/19/demand-for-hermes-bags-is-booming-despite-the-pandemic/>

^{*4} Source: DB Group Pricing Team Jan 2021; weighted averages per volume; Edahn Golan pricing from Jan 2020