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NamGem: Profits or Pipedreams?

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Diamond mining company Namdeb, a joint 50-50 partnership between De Beers and the Namibian Government, is bringing Lazare Kaplan International on board in January 2004 as a technical partner to help secure a future for its loss-making NamGem cutting and polishing factory. Lazare Kaplan, headed by American diamond magnate Maurice Tempelsman, is a market leader in manufacturing premium-priced diamonds and jewellery. There are two different ways of looking at this link-up and its ramifications for Namibia.

Namdeb is part of a consolidating industry, creating value across the entire pipeline

The optimistic scenario is that Namibia is a microcosm for the global diamond industry, which has recently seen many large companies trying to capture profits along the entire diamond pipeline from mining to jewellery sales through mergers, acquisitions and partnerships. Namdeb began as the world's leading alluvial diamond mining company in 1994, branched out into cutting and polishing in 1998 and is now teaming up with Lazare Kaplan, a company with a massive distribution network of wholesalers, manufacturers, and more than 1,500 jewellers worldwide. The firm will also contribute major marketing know-how. Lazare Kaplan will capture a wider market for NamGem's locally manufactured rough diamonds and eliminate much of the foreign currency risk. Namdeb says it will retain ownership of NamGem but after two years will offer Lazare Kaplan an equity stake in the company. Lazare Kaplan will also be able to supply its own customers with NamGem's polished diamonds. If successful, NamGem will boost Namibian employment, add value and thereby help Government realise its dreams of creating a vibrant diamond cutting and polishing industry. This deal then augers well for Namdeb and the Namibian economy.

But cutting and polishing is not working in Namibia

A more pessimistic view of this partnership can be viewed by way of the bottom line. NamGem was meant to be breaking even within five years and for many reasons, mostly beyond its control, has added value but not enough profits to cover its costs. NamGem said in a press release that its finances "have come under sustained pressure." The group says that manufacturing is constrained by low margins and high competition. In a previous study of the industry, the IPPR found that relatively high wages and the appreciation of the Namibia dollar have arguably made it economically unviable to be manufacturing in Namibia at all. Now that Namdeb, the domestic market leader, has had to bring in reinforcements, the national dream of a viable diamond manufacturing industry seems increasingly tenuous. If Lazare Kaplan is unable to make NamGem profitable then the diamond manufacturing industry will probably disappear altogether in Namibia. This is an industry on the brink of survival.

Confusion about the ownership component of the deal

Business Day broke the news of this deal on 10 November by reporting that Namdeb was in negotiations to give Lazare Kaplan the option to buy NamGem in two years time. The news of the deal was later covered in Namibian newspapers. One NamGem director even told the *Allgemeine Zeitung* (12 November) that

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NamGem has indeed already been sold to Lazare Kaplan. Officially, Namdeb and NamGem have confirmed Lazare Kaplan is coming on board as a technical partner and that it is envisaged the firm will take an equity stake after two years. But so far Namdeb, NamGem and Government have categorically denied any plans to sell NamGem outright, although there is always the caveat that two years is a long time. The divide between press reports and company statements has created considerable confusion.

Namibia dreams of adding value through cutting and polishing

Africa's raw materials have traditionally been shipped abroad to be processed and are sold at many times the prices paid in Africa. Namibia is part of a trend among producing nations that want to capture some of the profits further down the diamond pipeline. The Namibian Government believes that it can share in some of this value added through a viable cutting and polishing industry. The negotiations between Government and De Beers that led to the founding of Namdeb in 1994 also led to the creation of NamGem in 1998. It is understood that Government largely forced the building of the factory on De Beers, like in neighbouring Botswana. The world's largest mining group balked at competing with its own client base but gave in.

Through Namdeb's backing, NamGem became the largest factory in Namibia. Ironically, NamGem as a De Beers "sight holder" does not source its rough diamonds from Namdeb but from the DTC, De Beers' marketing arm in London. Although Namibia is known to have the finest diamonds in the world, manufacturers with "sight holder" status buy parcels from abroad that may not contain more than a few Namibian diamonds. Government sweetened the deal by offering "Export Processing Zone" status to the industry, which waives various taxes and duties. The Diamond Act of 1999 also gives the Ministry of Mines and Energy the right to force producers like Namdeb to make their rough diamonds available to the diamond processors. When the Okahandja-based factory received its cutting and polishing licence in September 2000 it was the first factory active in Namibia. Since then, investors from Belgium, Israel, Russia, Ukraine and the US have opened six other factories. Between them the factories now employ around 350 people, almost all of them Namibians.

But cutting and polishing in Namibia is not without obstacles

The factories were built and business models were approved despite several major obstacles. The most important hurdle is that there is no guaranteed supply of rough diamonds for the industry. NamGem and NamCot are "sight holders". LLD Diamonds Namibia, when it starts producing in April 2004, will source its rough diamonds from Samicor. It is unclear where the other four factories are sourcing their rough diamonds. In a rapidly consolidating industry this will increasingly become a problem. The DTC itself has sharply reduced its client base. That said, Government has recently been working on hard on helping local factories buy diamonds from Diamond Development Corporation (Diamdel), a DTC company that sells rough diamonds to non "sight holders".

Once these inputs are secured, Namibian factories suffer further from the fact that wage costs are very high in Namibia compared to other cutting centres. There are also massive training costs involved with trying to build an industry from the ground up. It is estimated that diamond beautification costs up to $30 per carat in Southern Africa compared to $10 in India and China. This makes it very cost ineffective to open a factory in Namibia. Local polishers argue that the recent appreciation in the Namibia dollar, now at a three-and-a-half year high against the dollar, has pushed local costs to as high as $40 per carat. Namdeb said in October 2003 that the "exchange rate challenge" is reducing profitability and having an adverse effect on its operations. The group said it was critically reviewing its business plans.

NamGem was supposed to break even within five years. So far the company says it has added value but its profits have not yet covered costs. It would come as no surprise if Namdeb were thinking about selling NamGem to Lazare Kaplan altogether. Such a move would be in line with De Beers' joint venture partner in Botswana, Debswana, which after 13 years sold its Teemane Manufacturing Company factory in May to Diarough, a leading Indian firm based in Antwerp.

Initial impressions about the deal

NamGem's board, which includes Namdeb and Government representatives, has been reconsidering its future for some time because of the sustained pressure on its finances. Government was opposed to using taxpayer funds, directly or indirectly, to subsidise the industry. The group decided to seek out a technical partner to secure NamGem's profitability and competitiveness. In June 2003, NamGem's board, drawing on Government and De Beers appointees, conducted a search for a suitable partner. The search was limited to "sight holders" and with an independent consultant came up with a short list of seven candidates. They chose Lazare Kaplan as a technical partner for a two-year period starting in January 2004 on the basis of its 100-page-plus proposal and its strong track record in Africa. None of the bids came from Namibian firms.

Financial details have not been made public. But because Lazare Kaplan is publicly listed in New York on the American Stock Exchange, it is likely that more information will soon be available. NamGem has said that Lazare Kaplan has invested US$100 million in recent years on "downstream branding and infrastructure, above and beyond its investments in multiple manufacturing facilities globally." NamGem says Lazare Kaplan is "is able and willing to commit considerable financial, technical and human resources to NamGem, mainly towards further upgrading and skilling of the factory's workforce." Because Lazare Kaplan will buy the rough diamonds from the DTC, NamGem claims this will remove many of the foreign exchange risks. None of the 110 employees will be fired and Martin Pearson will remain the General Manager. By contrast, "as the factory's performance improves, the focus can be on expansion of output, jobs and the profitability on which sustainable jobs depend." NamGem said that, even if no equity stake is taken, the company will "emerge as a stronger, more Namibianised company."

Lazare Kaplan a natural fit for Namdeb

Lazare Kaplan is in many ways an easy choice. In the business since 1903, the firm has long been a leader in the quality segment of the diamond manufacturing market. Its line of "ideal cut" diamonds is akin to the types of fine diamonds found in Namibia. Lazare Kaplan is based in New York and the company has very good access to the North American retail markets, the most valuable in the world. NamGem praised Lazare Kaplan as a publicly listed company for also having the necessary "public accountability and integrity."

Chairman Maurice Tempelsman, whose family holds a controlling stake in Lazare Kaplan, is very well known in Africa and all across the diamond world. Another family firm, Leon Tempelsman & Son, is active in mining, investments and business development and minerals trading in Europe, Russia, Africa, Latin America, Canada and the Far East. Maurice Tempelsman has been active in Africa since the 1950s. Lazare Kaplan, according to NamGem, has "pioneered diamond cutting in post-colonial Africa." In Botswana, Lazare Kaplan Botswana was for a long time the biggest cutting and polishing factory. Namdeb said that it was their work in Botswana, which focused on the manufacturing of "high quality" diamonds that especially impressed the board.

Maurice Tempelsman, a power broker and no stranger to Namibia

Maurice Tempelsman was born in Belgium and grew up in the US. He has been a prominent power broker for more than 50 years. He once tried to open the doors for De Beers in the US by arranging a meeting between managing director Harry Oppenheimer and President-to-be John F. Kennedy. He is a frequent visitor to Namibia and is said to be a close friend of President Sam Nujoma. In the mid 1990s he also acted as an economic advisor to the president. Tempelsman is credited for helping get Namibia and Botswana included in the African Growth and Opportunity Act (AGOA). He is the former Chairman of the Corporate Council on Africa, which represents nearly 85% of all US private sector investment in Africa. The African American Institute, which he also chaired, has helped many Namibians get the opportunity to study in the US, including the new Minister of Finance, Sarah Kuugongelwa-Amadhila.

Tempelsman made headlines in 2002 when a letter of his to President Nujoma was leaked to the media. In the letter Tempelsman allegedly offered to raise an offshore loan of N$500 million to cover the budget deficit if certain parts of the Diamond of Act of 1999 could be removed (see *The Namibian*, August 21, 2002). The sections in question are Section 58, which allows the Government to force diamond producers to make rough diamonds available to manufacturers and Section 59 which allows Government to test international market prices for unpolished diamonds by selling up to 10% of production in the open market. Sources close to the negotiations say the letter was misinterpreted.

But what makes Lazare Kaplan so different?

But how can Tempelsman turn a higher profit where NamGem failed? Why would Tempelsman want to operate in Namibia at all when the diamonds he will beautify will be sourced from the DTC in London? Why is he not heading for India and China where the wages are much more attractive? One factor may be that both Lazare Kaplan and Namibia are known for top quality diamonds. There has been much talk in the diamond world of branding and marketing strategies. In Windhoek this has invariably focused on creating a Namibian brand known for quality and therefore able to command a premium among diamond buyers. Another reason may be that NamGem's output, about 40,000 stones annually, will increase the amount of polished diamonds Tempelsman can make available to his own client base. This scale issue may outweigh cost considerations.

But Namibian diamonds are hard to get

Almost all of the diamonds produced in Namibia are mined by Namdeb and go to the DTC where they are sorted and mixed into parcels with diamonds from Botswana, South Africa, Russia and other places. It is currently impossible for Tempelsman to request parcels from the DTC made up entirely of Namibian diamonds. Another option is sourcing the rough from Samicor, the company that has recently taken over Namco and will begin production in March 2004. This is even more unlikely because Samicor's owner Lev Leviev is a major polisher himself and when he starts operating will want to manufacture the diamonds through his own LLD Diamonds. And since Tempelsman allegedly lobbied against Section 58 of the Diamond Act it is unlikely that he would now lobby the Government to invoke it on his behalf. After four years, this "nuclear option" has yet to be invoked, suggesting that Namibian manufacturers will have to continue securing (or not securing) rough diamonds on their own.

Focusing on high quality, Namibian branded diamonds may do the trick

On the other hand, Lazare Kaplan may be successful in repositioning NamGem. As a "sight holder" Tempelsman can get his hands on plenty of rough diamonds that can perhaps be branded as '"manufactured in Namibia". By focusing on a lucrative niche, like "ideal cut" diamonds or even a Namibian brand, the factory may be able to withstand the wage and productivity pressures from abroad. Canada, for one, is exploring various ways of obtaining a premium for its diamonds by branding and marketing them as high-quality products. This may work in Namibia as well. By ensuring that its manufacturing arm is viable, Namdeb and De Beers may also be able to defuse Section 58. If NamGem becomes profitable, takes on more workers and adds value without public funding, Government may point to NamGem as a reason why manufacturers should be able to cut and polish profitably without state support.

But the industry's days may still be numbered

NamGem says it looks forward to "a future of increased profitable production" through the assistance of Lazare Kaplan. But if such a turnaround fails to materialise there is every reason to think that Namdeb, Government and De Beers may chose to shut the whole factory down. In fact, there is nothing stopping the whole manufacturing industry from leaving for cheaper shores. The reality is that NamGem has so far failed to be profitable enough, almost entirely due to factors beyond its control. In fact, there is very little evidence of any diamond cutting and polishing factories in Africa turning a profit. Government is actively trying to build a viable industry. But if Tempelsman fails to turn NamGem around, the days of Namibia's diamond manufacturing industry may be numbered. The ambition of creating a profitable industry will have turned out to be a pipedream.