

Economics

Management Approach - Economics

Economics goes farther than merely considering the financial figures. We look at what is behind them, and what are the key factors contributing to them. We ask ourselves "Are there specific factors that either add value, or diminish it? How do we recognize these and what do we do about them?" One of the key factors contributing to the economics of a deposit is the value of the product. We take a lot of care to preserve the value of the diamonds we mine through undertaking the best recovery of diamonds that we can during the processing of ore to minimize diamonds being lost with the waste products, and also to minimize breakage of the diamonds themselves. Breakage could vary from shattering of individual crystals to chipping off small portions, both of which negatively affect the value and thus ultimately the revenue. Part of our internal due diligence in our processing plants is thus aimed at monitoring and minimizing losses to the value through breakage. The costs of operations themselves and the various overheads incurred by the offices are monitored and managed with care as well because these expenses also affect the overall value realized. Regular cost reviews and monitoring of revenue from sales against expectations help us to ensure that all reasonable steps are being taken to maximize the value of our product.

De Beers Canada contributes through its own two mines (Snap Lake and Victor) to both the economics of the De Beers Family of Companies and to the socio-economic wellbeing of Canada, particularly in Ontario and NWT where our mines are located. The economic recovery that started in 2009 continued through much of 2010. In gross terms, we employed 1,087 people and injected approximately \$474,900,000 into the Canadian economy in 2010. At Snap Lake, about 26 per cent of our work force is Aboriginal and at Victor, about 40 per cent. The salaries and wages for these individuals should flow to their communities, provided the individuals are still resident there. This financial contribution was through our operating costs, capital purchases and salaries and wages (for details, see Figure 4-2). Within this total, the breakdown into benefits from the purchase of goods and services from Aboriginal and northern suppliers is summarized in Figure 4-1. All of the production from both the Snap Lake Mine and the Victor Mine was purchased by the Diamond Trading Company (DTC) which is part of De Beers UK; 10 per cent of the carats by value from Snap Lake were offered for sale to local Canadian sightholders in the NWT for cutting by local sight holders under an agreement between De Beers Canada and the government of the NWT. A similar arrangement is in place for Ontario whereby 10 per cent of the carats by value from Victor were offered to sightholders for cutting under an agreement between De Beers Canada and the government of Ontario. Prices for rough (uncut) diamonds have returned to pre-recession levels and the demand for DTC sales in general has picked up. As rough prices



At Snap Lake Mine, a Jumbo drills holes in preparation for explosives.

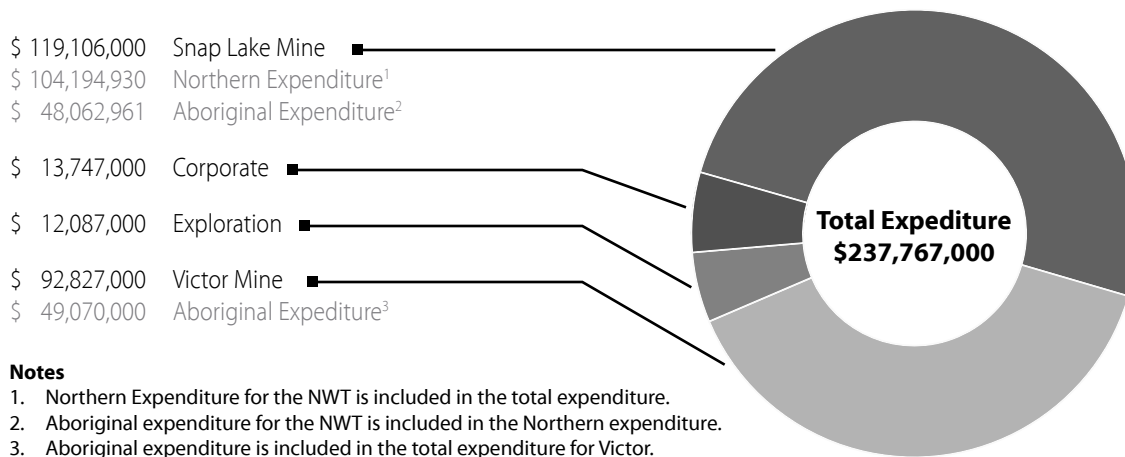
recovered, the polished prices have remained fairly consistent. Many additional steps were taken to reduce and contain costs and conserve cash to ensure that the company remains in good shape for the future.

Table 4-1 shows the economic goals for 2010, and summarizes the main successes and shortcomings. The major risks and opportunities for the company are summarised in Table 2-1. The economic goals remained essentially unchanged throughout the year although plans were in place to adapt to the changing economic circumstances if necessary. Note that all financial figures are rounded to the nearest thousand dollars. All amounts are in Canadian dollars, unless noted otherwise.

Table 4-1: 2010 economic goals and objectives

Goal	Degree achieved	Successes	Shortcomings	Additional remarks
<ul style="list-style-type: none"> EBITDA \$94M Free Cash Flow \$5M 	Achieved.	<ul style="list-style-type: none"> EBITDA = \$128.8M, Free Cash Flow actual = \$50M 		
Successful Execution of Victor Resource Extension Plan	Achieved.	4 holes completed to their planned depth, 1 hole was stopped about 100 m short because of the spring thaw.	Late arrival of permits caused the program to be modified from 6 drill holes to 5: 4 holes were completed, and one was stopped prematurely because of the onset of spring.	Some results for this work are still awaited.
Gahcho Kué: Positive feasibility study	Achieved.	Gahcho Kué feasibility study positive and robust.	A few items remain to be closed out and these are not expected to significantly change the viability.	
Safety LTIFR 0	LTIFR = 0.88		LTIFR = 0.88	
Environment AEIFR 18.5 or better	Achieved.		AEIFR = 7.1	
Talent Management program implementation by end of Q4 2010.	Gap analysis complete by end of Q4; plan in place for 2011.	Objective met.		
Snap Lake <ul style="list-style-type: none"> Carat target: 1,137,000 Safety LTIFR: 0 Dilution less than 38% 	Not achieved.	<ul style="list-style-type: none"> 926,000 carats recovered; LTIFR = 1.1; Dilution 42% 	Issues with dilution and safety; carat recovery for the year not met.	
Victor <ul style="list-style-type: none"> Carat target: 749,000 Safety LTIFR: 0 	Carat target met. LTIFR not met.	<ul style="list-style-type: none"> 826,000 carats recovered; LTIFR = 0.64 		

Figure 4-1: Total contribution to the economy in 2010



Notes

1. Northern Expenditure for the NWT is included in the total expenditure.
2. Aboriginal expenditure for the NWT is included in the Northern expenditure.
3. Aboriginal expenditure is included in the total expenditure for Victor.

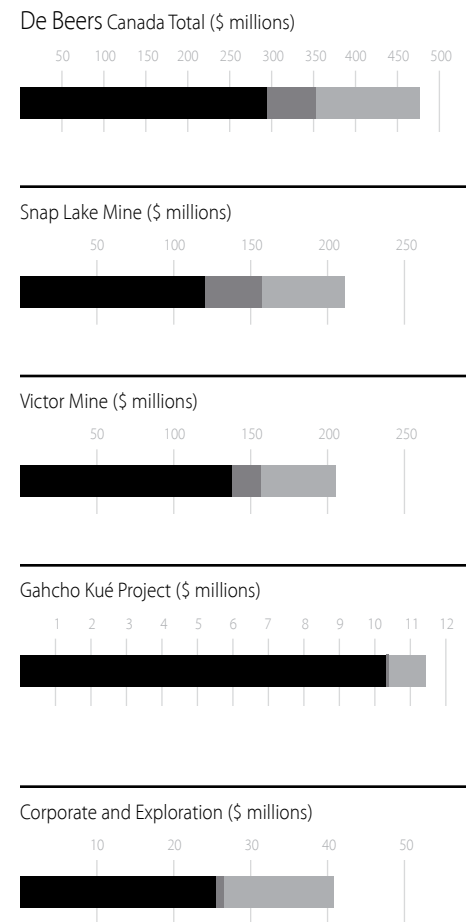
All contracts were paid in accordance with agreed terms, excluding any agreed penalty arrangements.

Total payroll and benefits, including wages, pension, and other benefits, consisted of \$14,770,887 for the corporate and exploration divisions, \$1,080,439 for Gahcho Kué, \$59,273,309 for Snap Lake and \$47,449,993 for Victor for a grand total of \$122,574,628 for Canada. In addition, redundancy payments were made totaling \$138,049 during 2010. Out of the 1,087 employees only 37 are within a defined benefit plan and this is not material for this report. The decision was taken during 2009 to freeze the defined benefit plan from December 2010, with all non-retired employees of the defined benefit plan then becoming members of a defined contribution plan beginning January 2011.

No corporate, federal, provincial taxes or government royalties other than personal income taxes were paid in 2010 as the company was in a loss position for tax purposes. In future years there are accumulated tax allowances from exploration, development and construction phases that will reduce tax payments for a while. A total of \$26,044,637.59 was paid in federal and provincial income taxes on the payroll, Canada Pension Plan contributions and employment insurance. Property taxes (including land use payments) totalled \$4,887,000 during the period. No federal, provincial or territorial subsidies were received during the year. Figure 4-2 shows the contribution to date to the economy.

No investment was made in public infrastructure through any commercial, in-kind or pro-bono engagement

Figure 4-2: Total contribution to the economy in 2010



Legend:

- Contribution through purchases of goods and services
- Contribution through capital purchases
- Contribution through salaries and wages

Financial highlights



Management Approach – Financial highlights:

Accurate recording and compilation of financial information are required in order for us to understand the financial state of the corporation, and also for us to plan and forecast what is likely in the future. Linked to this is a rigorous internal audit function, reinforced by external audits by independent third parties to ensure that we are functioning in a legal and compliant manner, and to provide the necessary checks and balances that any corporation requires. Part of our operating system is to reduce the use of cash within the company, and to centralize the collation of invoices and statements and to use a centralised payment system to the extent that it is practical. This reduces the risk to the company and lowers our vulnerability to some aspects of crime.

Financial Summary

Diamond production during the period was 1,751,000* carats made up of 926,000 carats from Snap Lake, and 826,000 carats from Victor. Total net receipts from the sale of 1,661,000 carats to the Diamond Trading Company were US\$446,020,000. The difference between the carats produced and the carats sold represents the change in diamond inventory on hand during the period.

Table 4-2: Financial highlights as at 31 December 2010.

	(\$ thousands)
Revenues	460,711
Operating Costs (excluding wages)	218,787
Employee wages and benefits	106,839
Operating Assets Amortization	93,058
Payments to Providers of Capital	71,286
Payments to Government	34,525
Non-Operating Costs (excluding wages)	16,828
Employee wages and benefits	19,991
Non-operating Assets Amortization	942

* Errors due to rounding

Pension and benefit payments included in Table 4-2 totalled \$8,693,700.

Table 4-3: Distributions to providers of capital

	(\$ thousands)
Interest on debt and borrowing	15,068
Re-financing fee	4,280
Net debt repayment	51,938

Note: Net debt repayment: \$69,709,000 repayment of bank loan less \$17,771,000 increase in intercompany payable balance.

Table 4-4: Other distributions

	(\$ thousands)
Dividends on shares	--
Dividends of preferred shares	--
Arrears of preferred dividends	--

Indirect economic impacts to the economy in general have been estimated by the Mining Association of Canada as being over 60 percent more than the direct economic impacts.

Four Impact Benefit Agreements are in place for the Snap Lake Mine, and there are three Impact Benefit Agreements and one Working Relationship Agreement in place for the Victor Mine. Each agreement is slightly different, reflecting the needs and priorities of the individual groups. Total payments to all eight Aboriginal communities with ratified and signed Impact Benefit Agreements and including the Working Relationship Agreement totalled \$5,231,000 during 2010. These payments include components for compensation, environmental monitoring, scholarships and the like, but exclude financial benefits related to business opportunities through the supply of goods and services.