DIAMONDS & JEWELRY

CURRENT TRENDS

- The success of retail jewelry businesses varies widely by concept, with branded specialty and off-price jewelers performing well in 2019
- Retail jewelry sales were down 1.3% year-over-year through November 2019, representing a slowdown from 2018
- Bankruptcies and store closures for retail jewelers were down 28% and 16.8%, respectively, in North America in 2019 per data from the Jewelers Board of Trade
- Value perception is paramount in the mined versus lab-grown diamond debate

PROJECTED VALUES
(12-MONTH OUTLOOK)

DECREASING STABLE INCREASING

APPROXIMATE NET RECOVERY ON COST

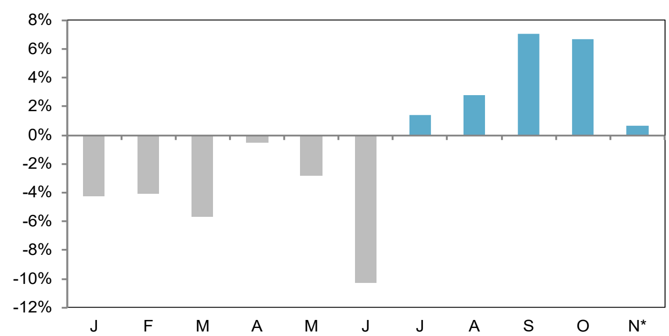
55-70%

low- to mid-range jewelers

75-85%

high-end & luxury jewelers

U.S. JEWELRY STORES MONTHLY SALES TRENDS



*Preliminary data
Source: Census Bureau

-1.3%

YTD U.S. jewelry stores' sales

-28%

increase in U.S. bankruptcies in 2019, with 18 filings

Gordon Brothers
1903
GORDONBROTHERS.COM
+1.617.426.3233

PERFORMANCE BY CONCEPT VARIED FOR 2019:

Mall-based Jewelers

Most mall-based jewelers saw a steady decline in foot traffic in 2019, a trend that is not expected to change in the near-term. In addition, in-house credit, which is a vital part of the buying process for this customer, became stricter in 2019, resulting in fewer approvals. The combination of fewer shoppers and less ability to close sales using company credit or financing options negatively affected retailers' ability to reach sales targets. Jewelry retailers that have maintained mall-based locations are facing higher marketing costs and lower margins; however, those with an adequate customer base that invested fewer marketing dollars in their business in 2019 showed modest comparable sales improvements over 2018. Higher rents and expenses have cut into the profitability of mall-based jewelers and many have begun looking at relocating, pursuing e-commerce platforms, or finding other solutions to a dynamic that has not shown signs of improving.

Specialty Retailers with Branded Merchandise

Jewelers in this category are typically multi-store operations that carry highly sought after branded products in jewelry and watches. Until around 2015, retailers in this space resorted to heavy discounting on luxury brands to drive inventory turnover and maintain sales growth. This strategy resulted in good topline numbers with weak gross margins, which is not sustainable for selling luxury products. Trends have since turned around with vendors and retailers proactive steps to avoid oversupply, including investing in branded shop-in-shops, website improvements, and social media platform expansion, making discounting much less prevalent. Major luxury brands like Cartier, Chanel, Rolex, Roberto Coin, Marco Bicego, and David Yurman are better positioned to help retailers by giving them market share and collaborating to ensure success by maximizing brand exposure and sales. Staff in these stores are well trained and adept at closing sales with less discounting.

E-commerce Retailers

While sales have grown in this space, value-priced branded products and higher-end diamonds backed by grading reports are generating most of the current e-commerce jewelry and watch business. Online consumers are primarily looking to purchase closeouts or off-price popular and desirable brands of watches and jewelry. This market will continue to grow as brands become stronger and tools for converting shoppers with artificial intelligence improve.

Department Stores, Warehouse Clubs, and Off-price Retailers

This group has seen mixed results over the past year. Warehouse clubs have grown their jewelry category to a very healthy business despite the fact that most do not employ dedicated jewelry associates. This has resulted in lower costs but also lower margins for the segment.

Off-price retailers have recently had great success buying large quantities of discounted jewelry and watch inventory from manufacturers and closeout resellers to sell back into the retail market. In a change of strategy, brand name vendors are now selling aged products to off-price buyers who then run short, small-scale promotions to achieve maximum sales volume. In the past, brand name vendors were reluctant to sell their products to off-price retailers for fear of hurting their full-priced customers; however, they have since found that the channels do not typically share the same customer base.

Big-box discount retailers had mixed results in 2019 in jewelry departments. These retailers have tried adding new items such as lab-grown diamonds and value-priced silver and diamond products with some success. However, the lower-priced watch category has suffered in this space, as brands that once dominated this sector have recently declined to levels that have made stocking these goods a questionable business practice.

IS LAB-GROWN THE FUTURE OF DIAMONDS?: The lab-grown diamond market went through an industry-changing shift in 2018, as the De Beers Group, which owns over 40 percent of the diamond market, became a producer. After years of downplaying lab-grown stones as less desirable (and less valuable) than natural stones, De Beers' lab-grown diamond concept, Lightbox, launched in late 2018. De Beers' entry into the lab-grown market served as a major endorsement of lab-grown stones as a legitimate alternative to natural stones. Further, DeBeers' market entry served to establish a new low in retail pricing per carat to just $800 versus a (pre-Lightbox) retail range of similar quality lab-grown stones at $3,000 to $8,000 per carat.

At the time, the Jewelers Board of Trade noted "the debate between real vs. synthetic is here to stay," adding that De Beers' entry into the market "is a response to reports that U.S. millennials are driven to lab-grown diamonds due to popular pricing and a definitive transparent supply chain." Heading into January 2020, analysis from Creditntell indicates that consumers will be looking to shop synthetic diamonds and fashion jewelry in the coming year.

According to the 2019 *Global Diamond Report* from Bain & Company, mined rough diamond sales are expected to have declined by 25 percent and polished diamond sales by 10 percent in 2019. Bain predicts that 2020 will be another tough year for the industry with flat retail growth due to online sales, lab-grown diamonds, and consumers' growing demand for environmental and social responsibility. The report estimates lab-grown diamond growth from 15 to 20 percent in 2019 and expects market share to grow quickly. Morgan Stanley estimates that by 2020, lab-grown diamonds could account for 15 percent of sales of gem-quality melee diamonds and 7.5 percent of sales of larger diamonds. Independent data consultant, Paul Zimnisky of Diamond Analytics, projects the lab-created diamond jewelry market will grow to $15 billion by 2035.

VALUE PERCEPTION: Jewelers have historically bolstered the resale market of mined diamonds by offering a buy-back price on upgrades and tout this as an advantage over lab-grown stones. However, many lab-grown diamond companies, like Ada Diamonds, offer buy-back or trade-in guarantees as well. Based on reporting by Rob Bates, news director of jeweler magazine JCK, jewelers across the United Sates offer a range of policies with regard to upgrade trade-ins and buybacks on lab-grown products, with some retailers extending the privileges for synthetic diamonds. Lindsay Reinsmith, co-founder of Ada Diamonds, believes that the conversation around lab-grown versus mined diamonds has shifted to the financial aspects because it is "their last calling card" and that raising the perceived value of mined diamonds is an effort to suppress competition from lab-grown diamonds. Marty Hurwitz, CEO of MVI Marketing, which is a leader in market research for the jewelry industry, asserts that consumers looking to sell back mined diamond jewelry would be shocked at the devaluation.

Moving forward, to the extent that lab-grown market pricing decreases sharply, profit margins of competing lab-grown producers could fall. Similarly, customers for lab-grown stones may have reduced incentive to purchase if trade-ins and buybacks are not guaranteed as they have been historically for mined stones. This development is expected to play out in the industry over time, and the implications are as yet not fully known. Understanding the implications of changing values for owned lab-grown diamond inventory may require an updated appraisal or the implementation of a sell-down strategy to reduce risk for a potentially devaluing asset pool.

The Expert: Leonard Polivy

Leonard Polivy brings over 30 years of hands-on experience in the jewelry business to Gordon Brothers where he works on a variety of retail dispositions and appraisal projects. Read his full bio [here]

Gordon Brothers
1903
GORDONBROTHERS.COM
+1.617.426.3233