From:

Groundswell Holdings (Pty) Ltd; Rational Expectations (Pty) Ltd; Rozendal & Associates Holdings Ltd; Rozendal Partners (Pty) Ltd; Peter D Wimsey & Associates (Pty) Ltd

Care of:
Groundswell Holdings (Pty) Ltd
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To:

Directors
Gemfields Group Limited
1 Cathedral Plazza
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7 August 2020

OPEN LETTER

Dear Sirs

Gemfields Trading, Corporate & COVID-19 Update

We have taken note of the contents of the "*Trading, Corporate & COVID-19 Update***"** released by Gemfields Group Limited on 29 July 2020. The announcement raises the following concerns:

… ***Net Cash*** – there has been a significant decline in the company's net cash position, down by $23,8m in the two and a half months since the 17 April 2020 announcement.

… ***Cash generation*** – 92% of the company's revenues come from auction sales. With the 14-day quarantine period in Hong Kong extended until 31 December 2020, it looks unlikely that a successful auction will be possible this financial year.

… ***Funding*** – the announcement noted that a rights issue may be necessary, and, in our view, this is the likely scenario. We estimate that the company would need to provide a buffer of at least 6 months' worth of operating expenses to bridge the likely time gap before another auction is possible. Based on our estimates this would require a rights issue of at least $45m, possibly more.

  At the date of this letter (6 August 2020) the market capitalisation of the company was approximately $90m, meaning a rights issue at the level above would amount to at least 50% of the company's current market capitalisation, a significant dilution to shareholders unable to follow their rights.

A discounted equity issue should be a measure of last resort and only proposed after management has taken all available preventative measures possible, without risking long term impairment of the core function of the company, which we consider the mining and selling of coloured gemstones.

Cost Cutting and Cash Preservation Measures

In the announcement the point was made that *"should it become clear that hosting gemstone auctions by the end of December 2020 is unviable, additional cash maintenance measures will be implemented"*. We believe it is clear already that an auction will not be held before the end of the year, therefore further cash preservation measures should be implemented as a matter of urgency.

These measures should include:

- Converting non-core assets into cash including:
  - accelerating the sale of the stake in Sedibelo;
  - realising the $5,4m held in inventory of cut & polished product (which do not appear to be required to support any of the businesses);
  - dealing with Faberge (see below).

  The overriding consideration in realising these assets is that it is far better to sell a part of the company at a discount than selling the whole company at a discount under a rights issue.

- Raising further debt to bridge the funding gap between now and eventual auction revenue or non-core asset sales proceeds. We are aware of and supportive of the company's efforts in this regard.

- Aggressive cost cutting based on a worst-case scenario, as opposed to the perceived 'wait and see' approach. Urgent steps need to be taken to preserve cash until there is more certainty regarding the future. In this regard we recommend:
  - *Head office costs* - the announcement showed savings by segment for April-June 2020 compared to the prior year, however, this was not provided in respect of head office costs. The only information provided was a temporary 20% salary cut linked to moving to a 4-day week.

    Before capital is requested from shareholders, it is our expectation that the company should implement and communicate significant cost cutting at head office targeting reductions in all major expense lines, including:

    1. Marketing & advertising spend, including head count and related agency fees. It is our understanding that a reduction in spend is already being implemented, but these reductions should be made permanent along with an adjustment to the marketing department staffing levels.
    2. Staffing costs, with permanent reductions in headcount to reflect the uncertain future faced by the company. It is inconceivable that not one redundancy has been made.
    3. Professional fees - Our work indicates that, on a comparable company basis, Gemfields' professional fees are excessive. For instance, we note that Gemfields has an internal Investor Relations as well as outsourced third parties providing services in both South Africa and the UK. Furthermore, we note the appointment of a joint broker despite the low share trade volumes on AIM.
  - *Head office location* - as part of the cost reduction process, serious consideration needs to be given to the logic behind a London based head office, which results in higher costs than would be the case if the head office was based in a lower cost jurisdiction e.g. South

Africa, which is located closer to the mines and has the requisite human capital available.

The pandemic presents an opportunity for the company to permanently lower its fixed cost base on a sustainable basis to be more in line with its peers. This opportunity must be taken.

- *Faberge* – despite the case presented by management, we remain unconvinced that owning Faberge is at all necessary for the success of the core coloured gemstone mining business. With the Covid-19 related pressures, the continued investment of valuable cash in a business that remains a significant cash drain (and is likely to remain as such for some time) is a luxury the company cannot afford.

  Our view is that the Faberge business should be exited, however, we understand that this may take time to achieve in the current environment. Until then the business should be held on a 'care and maintenance basis' i.e. all costs should be pared back aggressively, all loss-making retail sites should be closed and there should be no further investment in inventory. The company should communicate that the business is non-core.

Alternative revenue & continued mining

No announcement has been made regarding alternative revenue generating measures that have been explored, including the possibility of implementing a system like Gem Diamonds, who replaced their tender system for large diamonds with a flexible direct sales process due to the travel restrictions.

Furthermore, management should be able to gain a good understanding of the current client demand for rubies and emeralds. If there is reasonable demand for rubies, we would recommend the board gives serious consideration to opening up MRM sooner rather than later, given that there is both insufficient stock of premium rubies and that the cash cost of closing MRM is not significantly lower than operating it.

Conclusion

In summary, the company needs to take further urgent steps to preserve cash, prioritising the sale of all non-core assets. The company must move heaven and earth to avoid issuing shares at a discount. This will present management with some uncomfortable and difficult choices but, the decision by shareholders to support any funding requests and the conditions attached thereto will depend on the degree to which management have taken all possible actions to avoid requiring additional shareholder funds.

We understand these are challenging times and we would welcome the opportunity to engage with management and discuss in further detail the measures proposed above.

Yours Faithfully

William Marshall-Smith
William Marshall-Smith (Aug 7, 2020 13:11 GMT+2)
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