



Dominion Diamond Corp. Popped 20% When a Hedge Fund Got Involved

Description

Dominion Diamond Corp. (TSX:DDC)(NYSE:DDC) is the only major diamond producer operating exclusively in Canada with two of the richest-producing diamond mines in the world.

After falling roughly 50% in the past 12 months, its stock jumped over 20% on Tuesday when a Toronto-based hedge fund controlling 5.4% of shares started an activist campaign. The hedge fund believes that Dominion's share price has "suffered excessively and unnecessarily as a result of misguided policies and missed opportunities." After the announcement, Dominion reportedly hired Rothschild & Co. to advise on a potential sale of the company.

Are big changes on the way, or will investors end up disappointed?

Tough times for the industry

While Dominion's management team has highlighted various ways it can grow the business, no miner can overcome a bear market in its primary commodity. This year diamond prices have fallen 15%, while demand projections continue to come down. In addition to Dominion, no competitor has been able to fight the tide. That includes **Petra Diamonds Limited**, which is down 52% this year, and **Anglo American plc**, which is down 75%.

Despite a tough industry outlook, Dominion is pushing forward with growth projects. The company will end up spending \$209 million in projects this year and has plans to spend an even greater amount in 2016. Most competitors seem to disagree with Dominion's rosy outlook. Industry giant **De Beers SA** announced that it will cut diamond production by 10% this year and will cut a similar amount next year. Dominion, however, still believes its contrarian stance will pay off.

Will demand rise?

Underpinning Dominion's bullish outlook is its expectation that demand will grow. While total consumer spending on diamonds was \$25 billion in 2013, the company believes this will grow to \$31 billion by 2018.

So far, this projection looks overly optimistic. Chinese demand, the primary source of growth, has been surprisingly underwhelming. As a result, diamond inventories have been piling up, contributing to depressed prices. Without demand growth from China, Dominion is in a tough position.

Management missteps like this are a big part of why investors are calling for changes. For now at least, it appears as if shareholders can expect some relief.

Room for changes

K2 & Associates, the hedge fund that started an activist campaign, revealed that Dominion's independent directors have agreed to meet the first week of January. One major source of discussion should be the firm's massive cash pile. The miner has amassed net cash of \$284 million, which is equal to about 40% of its market capitalization.

While management wants to continue pouring this into growth projects, these funds are perhaps better used for a massive share buyback. Not only would this help support the stock price, but it would also provide current investors an additional reason to hold the stock. Cash flows from impending projects aren't expected to flow until mid-2016. If the company's directors agree, this could help sustain the recent pop until cash flows grow or an acquirer is found.

CATEGORY

1. Investing
2. Metals and Mining Stocks

POST TAG

1. Editor's Choice

Category

1. Investing
2. Metals and Mining Stocks

Tags

1. Editor's Choice

Date

2025/08/04

Date Created

2015/12/23

Author

rvanzo

default watermark