

## **Sarine Technologies Ltd**

(Incorporated in Israel)

(Israel Registration No. 51 1332207)

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### **RESPONSES TO QUESTIONS RECEIVED FROM SHAREHOLDERS FOR ANNUAL GENERAL MEETING TO BE HELD ON 25 JUNE 2020**

The Board of Directors (the “Board”) of Sarine Technologies Ltd. (the “Company”) refers to the announcement dated 1 June 2020 on the Live Webcast of Annual General Meeting on 25 June 2020 (the “Announcement”). Further to the Announcement, the Board and Management had received questions from shareholders for the period between 1 June 2020 to 19 June 2020 (“Questions”). Questions received from shareholders but are not provided with any response are due to reasons of commercial sensitivity or not substantial and not relevant. The Company and the Board wishes to provide its responses to questions that are substantial and relevant as set out in the Appendix A. The Company would like to thank all shareholders for questions submitted in advance.

#### **BY ORDER OF THE BOARD**

**Daniel Benjamin Glinert, Chairman of the Board**

**24 June 2020**

## APPENDIX A

### AGM Q&A:

#### **1. When can we expect to see a recovery in the diamond industry?**

- a. The pandemic has clearly impacted the diamond industry, as it has most everything else. Most critically, jewelry stores have closed their doors, initially in the Asia Pacific region and then, on a rolling basis, in Europe and the key U.S. market. Due to a government mandated lockdown India's cutting and polishing manufacturing centres were forced to stay closed for nearly two and a half months, from late March until the end of May, significantly impairing our revenues in Q2, as we noted in our April 26th update to our investors. De Beers has had to cancel its March and May sale "sights" due to low demand for rough as well as the fact that buyers couldn't travel to view the merchandise. Alrosa has significantly increased its digital tenders in lieu of its typical sales channels in Moscow which have been closed. The latter is a very positive development for Sarine in two ways. In the short term, more tender stones are being scanned on our Galaxy<sup>®</sup> systems thereby generating more revenues. More importantly, this continues to validate the beneficial role we can fulfill in enabling better (and more profitable) rough trading by producers, enhanced by digital data and enabled through digital channels, as has already been adopted by Lucara.
- b. There are some signs of recovery. Chinese retailers are open again and India has allowed manufacturing to restart in the key Surat polishing hub, albeit at a maximum of 50% capacity (our Galaxy scanning data show average throughput is at about 40-50% of normal operations). The main Indian trading offices in Mumbai are allowed 10% of their employees on site. There are discussions on the DeBeers June sight being held in a location more readily accessible to buyers. Still, having bought heavily in January and February, the midstream cutters are sitting on an inventory of rough stones, which may very well suffice through mid Q3, as well as on an inventory of polished stones, which had been polished in 2019 in expectation of a robust 2020 Chinese New Year and Valentines' Day period.
- c. The main issue remains the pace of the re-opening of the key U.S. retail market and what the consumer sentiment will be when the retail re-opens. Initial indications show a significant rebound in May retail sales in the U.S. – up 17.7% from end-of-April lows. Still, retail activity is 6% less than during May 2019. Diamond jewelry retail is also in the process of reopening but it too is still not at regular levels and the recent civil unrest which targeted retail in general and high-end retail specifically, may have delayed the re-opening somewhat in the immediate term.
- d. It is too early to provide a reliable forecast on the rebound of the diamond jewellery retail trade, as required for an overall recovery of the diamond industry value chain. We would expect, assuming no second wave of the pandemic, a partial return to normalcy in Q3 and a more robust return to normal value chain flow towards the end-of-year 2020

holiday season (assuming a normal or possibly even above normal holiday season).

**2. Please update shareholders on the latest state of the business**

- a. See response to [1] above.

**3. In the current difficult environment, how are the Indian manufacturers financing their capital equipment purchases? Is there a credit tightening /loosening in India? And how is the company managing the credit terms?**

- a. During this period the Indian manufacturers have mostly been on lockdown, hence they have not, for the most part, been placing capital equipment orders. As they have restarted manufacturing activities, we are making limited deliveries of capital equipment, mostly that ordered before the lockdown. The manufacturers are financing these purchases as usual – through bank credit financing and, depending on their history with Sarine, through credit terms.
- b. We have no concrete information on whether credit is being tightened or loosened in India. The lines of credit are primarily applied to the buying of rough stones and the acquisition of capital equipment is a far second priority. Give that, as noted in [1a] above, very little rough material has been bought during the lockdown, and, commensurately, very little polished goods have been sold, it is yet too early to truly assess the banks' approach to the tightening / loosening of our customers' credit lines.
- c. We are, as always, very carefully managing our credit terms. Typically, the terms are a down-payment before delivery and then payment terms which differ for various customers depending on the scope and history of their business with us. In these more difficult times, we are, by necessity, providing more extended credit terms, primarily to our core key customers.

**4. Why has the number of Galaxy systems increased (more than doubled) but the revenue has not increased?**

- a. The recurring revenues from our Galaxy<sup>®</sup> systems are not directly correlated to the absolute number of systems in our installed base on a one-to-one basis. This is because different models of our Galaxy<sup>®</sup> family of inclusion scanning systems cater to different sizes of rough diamonds and they thus generate very different revenue streams. We launched the initial Galaxy<sup>®</sup> model in 2009 to scan rough diamonds of 2.5 carats and above. This was followed by the Solaris<sup>®</sup> to scan sizes between 0.9 and 2.5 carats, the Meteor<sup>™</sup> to address stones between 0.4 and 0.9 of a carat and lastly the Meteorite<sup>™</sup> for stones below a 0.4 carat in weight. Because of the value added, we generate much more revenue from scanning a larger much more valuable diamond than from a smaller one. Though our significantly increased installed base has, in fact, scanned record numbers of rough stones in each of 2018 and 2019, the value of these record scans has not increased linearly because the vast majority of recent sales have mainly been of the Meteor<sup>™</sup> and Meteorite<sup>™</sup> models

catering to the very small and smallest rough stones. This does add to the overall number of stones scanned but very much less to our revenue.

One must keep in mind the various tiers by carat weight and value of rough diamonds, which comprise the value pipeline in any given year. Please note the table below reprinted from Tacy Inc. The GIA Too Big to Fail dated 27 February 2014. Though dated, it is a quite accurate representation of the value chain composition relevant today as well.

Carat and Size Distribution of Global Polished Output					
Size Range	Carats (millions)	Stones (millions)	Avg \$/carat	Value (\$ million)	Price \$/stone
1ct plus	1.27	1.05	4,800	6,096	5,806
0.50-0.99 cts	1.70	2.10	2,100	3,570	1,700
0.20-0.49 cts	3.64	10.51	825	3,003	286
0.07-0.19 cts	6.93	52.56	425	2,945	56
Below 0.07 cts	18.46	919.78	350	6,461	7.02
Total	32.00	986.00		22,075	

Note that the size range in the leftmost column is in polished weight, so one needs to assume a rough weight at least 2 – 2.5 times higher. As can be seen, the number of larger stones, those processed by our Galaxy<sup>®</sup> and Solaris<sup>®</sup> models, is, actually, very limited – no more than 1.5%(!) of the total annual output, measured in absolute stone numbers (approximately a third by carat weight and two thirds by dollar value). It is from these stones that we generate most of our revenues. The increase in our installed base over the past two years, the doubling aptly noted, has been, as noted above, primarily through the accelerating sales of our Meteor<sup>™</sup> and Meteorite<sup>™</sup> models for very small rough diamonds. Though these market segments are huge in number, which is why we have sold so many of these systems, especially in 2019 and, as noted in our April 26<sup>th</sup> update to our investing public, a record 50 in a pandemic-truncated Q1 of this year, our recurring revenues from each system are very significantly less. A single rough diamond scanned by one of our Galaxy<sup>®</sup> systems is typically worth thousands of US dollars (again, see table above – rightmost columns), while as a stone scanned by a Meteor<sup>™</sup> / Meteorite<sup>™</sup> model is most often worth just a few hundred or even but a few tens of dollars – a factor of ten less and even more. As there needs to be economic sense to our rates for scanning, there is a correlation between these and the average value of the scanned stone. Thus, revenues from a single Galaxy system are typically tenfold and more than that realised from a Meteor<sup>™</sup> / Meteorite<sup>™</sup>.

- b. In addition, due to the very different value proposition of the systems for small and very small rough diamonds, the systems' selling prices are also significantly less, and a segment of our customers opt to buy these systems on a one-off basis, paying an upfront price 4-5 times higher than our normal selling price, but with no follow-on per-scan charge. This, of course, reduces the growth in our ongoing scanning revenues.
- c. Finally, in various years, the total numbers of rough stones entering the value pipeline and their dispersion by size and value differ. Specifically, as noted in past investor presentations, in the last quarter of 2018 and the first three quarters of 2019, the number of stones sold by producers

(miners) dropped by some 25%, on an annual basis, compared to previous comparable periods. Obviously, this too also reflects on our revenues from our scanning services. In essence, the fact that our revenues did not *decrease* in 2019 in line with the drop in overall polished stones, is a result of the expanded installed base and, more importantly, the relative stability in the number of larger stones polished, from which most of our revenues are derived, as explained in [a] above.

**5. In the current environment, how are Sarine's competitors doing?**

- a. As all our competitors are private companies, we do not have access to their internal data. Obviously, our Indian-based competitors were completely shut down during the mandatory lockdown period. As of this writing, our primary competing entity has re-opened their facility, but, to the best of our knowledge, only on a partial basis, due to a significant portion of his employees having left Surat during the lockdown to return to their villages.

**6. Please update on the partnership with Tiffany; When will revenue from this partnership be realised?**

- a. Unfortunately we are not at liberty to provide any details with regards to our cooperation with Tiffany and Co. Having said that, obviously, as there have been lockdowns both in Israel and in New York, there has been a loss of productive time during these periods.

**7. Please update on the partnership with NGTC; When will revenue be realised?**

- a. The terms of our agreement with NGTC prohibit any ongoing updates to the public on the progress of our joint efforts, until such time as deemed appropriate by NGTC. Having said that, obviously, as there have been lockdowns both in China and in Israel, there has been a loss of productive time during these periods.

**8. What is traceability and to whom / why is it important?**

- a. Sarine's traceability solution, the Sarine Diamond Journey™, provides two facets – the storytelling aspect and the sustainability / responsibility aspect. The storytelling aspect of the traceability service provides the retailer with imagery of the rough diamond and the various stages of its making into a polished gem, optionally even with a 3D-printed model of the original rough diamond from which the polished stone offered for sale was derived. These, along with other retailer-specific material, provide a means for the retailer to enhance its brand and differentiate itself from its competition. This aspect has been the majority of adoptions of the Sarine Diamond Journey™ to date.
- b. The sustainability / responsibility facet of the Sarine Diamond Journey™ is one which is commanding more and more attention. This service, launched earlier this year, is intended to provide today's growingly conscientious retailers and their customers with the comfort that their

polished diamonds originated from rough stones that were sustainably mined, were not associated with any conflicts, were produced using fair labor practices and by companies who supported the communities in the producing countries. Furthermore, it is desirable that their polishing was done with the appropriate attention being given to safe and equitable working conditions, as well as reciprocal beneficitation to the communities in which the polishing was done. Sarine's service, which is gaining the support and cooperation of leading producing miners, generates visual and other documentary evidence serving these issues. The rough stone is initially imaged at the mine, is re-verified at the polisher prior to its being documented throughout the polishing sequence and is validated again when fully polished. It can also, optionally, be assigned a unique fingerprinting encryption, which can subsequently, at the wholesale and retail levels, whether mounted or still loose, be verified, and the diamond's authenticity, source-to-retail trace and grading report thus substantiated. This offering is currently generating growing interest from high-end luxury retailers across all geographies.

**9. What is different about Sarine's Diamond Journey™ traceability compared to DeBeers Tracr or GIA's Origin?**

- a. Our traceability is implemented throughout the value chain with minimal disruption to the normal work flow, very little added overhead and very minimal costs.
  - i. The stone is initially scanned at the mine by a process which takes less than a minute , so no significant overhead or cost is incurred.
  - ii. Subsequently, at the polisher's facility, the stone is processed only through the normal work-flow. The sequential polishing steps are documented throughout the normal processing sequence and the traceability data are automatically uploaded to the cloud by our various systems in parallel and transparently to the polishing effort. Thus, there is effectively no disruption of the normal work flow and no meaningful overhead / extra cost.
  - iii. Finally, the polished diamond's identity is validated, a process that can be typically done during the 4Cs grading process. In Sarine's solution this will be done during our new e-Grading technology in- house at the manufacturer's facility significantly cutting time (on average a week) and cost (insurance, shipping, etc.), as detailed below in a subsequent response. At this stage the polished stone can also be assigned a digital fingerprint, a method of identification which is much more robust than the current norm of just engraving the 4Cs report's number on the stone.
- b. The main advantages of Sarine's traceability solution are:
  - i. Our solution relies on manufacturers' existing infrastructure of Sarine's technologies - last year alone some 70 million stones were manufactured utilising these technologies. It can therefore be easily implemented on a wide scale.

- ii. The traceability data is derived directly and automatically from our systems along the production pipeline (IOT), as compared to data that is manually provided by pipeline participants in other paradigms. This enables the traceability to be based on verifiable data received autonomously, rather than on manual declarations and audits.
- iii. As our solution utilises data from throughout the manufacturing process, it inherently enhances the ability to show and tell the diamond story for brand enhancement purposes - for example the ability to provide imagery and even 3D models of details of the manufacturing processes. Some other solutions only provide start and endpoint data and the midstream processing from rough to polish is a black box

**10. What is e-Grading and what are its advantages to the industry? What is the business model?**

- a. E-Grading is our newly announced revolutionary paradigm for the on-site in-house grading of a polished diamond's 4Cs. E-Grading is based on our industry standard Cut grading technology, as realised in either the DiaMension<sup>®</sup> HD platform or the Axiom<sup>™</sup>, if symmetry grading is also required, and our unique technology-based AI-driven Color and Clarity grading solutions, augmented by software for in-process verification. Together these platforms and interconnecting software provide our customers, primarily but not only in the midstream manufacturing segment, the ability to ascertain and generate an objective, accurate and consistent grading of the vast majority of their polished diamond's 4Cs, which is automatically uploaded to our cloud repository with no human judgement calls or other subjective intervention. These reports are directly generated on a manufacturer's premises with no need for the time-consuming (on average a week) and overhead-heavy (insurance, shipping, customs handling) outsourcing to a third-party's offsite gemmology laboratory. Furthermore, as the work is performed by the manufacturer's own personnel (with no ability to intervene in the automated process or even access the results prior to their being uploaded to our cloud for safekeeping), the manufacturer's direct costs are also significantly less. The assessed stone's 4Cs can subsequently be shared digitally for B2B trading and, at an additional cost, also made available to the retail consumer, along with additional retailer-requested Sarine Profile<sup>™</sup> data (e.g., Sarine's light performance grading, the Sarine Diamond Journey<sup>™</sup>, Hearts and Arrows analyses, etc.).

**11. In recent years the company developed AI-derived 4Cs grading and Sarine Diamond Journey<sup>™</sup>; How much revenue was realised by these new technologies in the year 2019? What is the gross profit margin of these new technologies? Could you provide a prediction of revenue growth rate?**

- a. The contribution of the Ai-derived 4Cs grading and Sarine Diamond Journey<sup>™</sup> was still only some 3% of our revenues in 2019. Note, however, that the 4C's grading was effectively launched in mid-2018 and the Sarine Diamond Journey<sup>™</sup> only in 2019.

- b. The gross profit margin is dependent on the implementation of these solutions in the value chain work flow. If executed by our own staff at our own established gemmology laboratories, as by other offerors of similar services, the gross margin is around 60-70%. However, as the technology evolves, most of the realisation of these services will be performed autonomously within the normal work flow by automated processes, typically at polishers' facilities, as explained above in responses [9] and [10] pertaining to the advantages of our Sarine Diamond Journey™ solution and our new e-Grading paradigm. This will result in significantly higher gross margins, which will enable us to be much more cost-efficient and pass a portion of these savings on to our customers, making our offerings all that more attractive.
- c. We do not, as a habit, provide forward-looking predictions of revenue growth. However, we can note that the Sarine Diamond Journey™ and e-Grading are complementary technologies together providing a unique seamless, cost-effective and time-saving solution for some of today's manufacturers' and retailers' evolving needs. Also, we would again reiterate that the addressable market for the 4Cs e-Grading is over US\$ 500 million recurring annually. We believe we can over time, in light of the uniqueness of our solution and its integrative nature with our traceability solution, become a meaningful player in this market.

**12. What is the impact of synthetic diamonds on the industry?**

- a. Synthetic diamonds, more accurately termed Lab-Grown Diamonds (LGD), remain an insignificant fraction of the overall retail diamond market at this time. Their impact is primarily on smaller goods, though stones of a carat or two are available. Most industry players (e.g., 80% of RapNet members polled in mid-2019) view them as little more than fashion jewellery with no intrinsic value. Due to various factors including the U.S. Federal Trade Commission ruling forbidding unsubstantiated claims as to LGD being more eco-friendly and sustainable, the natural stone retaining its allure of being unique and from a finite non-replenishable source, and the questionable long-term value retained by an LGD (as their quantity will evidently grow over time), it remains debatable as to the long-term market share LGD will capture. Still, there are retailers, mostly in the U.S. but also in other markets including the Asia Pacific market, who offer LGD, usually as a lower-cost / value product, sometimes in parallel to their offered natural stones.
- b. We again emphasise that our technologies are also applicable to LGD. For High Pressure High Temperature (HPHT) derived LGD, currently the predominant technology utilised in the manufacture of LGD, the processes applied to natural diamonds are applicable to them as well, making their eventual market share less of an issue to us. As for Chemical Vapor Deposition (CVD) derived LGD, the technology applied to produce larger higher-quality LGD, like DeBeers' Lightbox line, though these tend to be somewhat cleaner and more uniform than HPHT LGD, arguably requiring less automated inclusion scanning, at the current state of the art they too definitely benefit from automated



inspection for inclusions and subsequent planning processes. Furthermore, these CVD LGD actually create a new market for our laser cutting systems, which excel at processing these stones. Paramountly, our endeavours relating to the retail trade of polished diamonds, the Sarine Profile™, AI-driven grading of the 4Cs and the Sarine Diamond Journey™, as they pertain to branding, consumer experience and confidence, are equally applicable to the LGD consumer market. There is evident consumer demand for the full grading of LGD, notwithstanding efforts to the contrary by some grading players, and our more economic e-Grading may significantly benefit from this trend. The retail sale of LGD will not differ materially from that of natural stones – the stones' story, albeit with an emphasis on other of their facets, will need to be told and the emotional connection with the customer created.