ALROSA Q2 & H1 2013 IFRS Results

Conference Call Summary

September 16, 2013

ALROSA speaker

Igor Kulichik – *CFO*

Presentation

Igor Kulichik (translated)

Ladies and gentlemen, I am Igor Kulichik, the Company's CFO. On behalf of ALROSA, I welcome you to this call dedicated to our Q2 and H1 2013 results. To begin with, I would like to give you status updates on the developments since we last met on a conference call.

Please direct your attention to page 3. Let me explain first our developments regarding resource base of ALROSA. ALROSA established this summer two joint ventures with ENDIAMA and Botswana Diamonds for diamond exploration in the Republic of Angola and in Botswana respectively. Territories in these two countries are among a few promising places on Earth with high probability of new discoveries.

In August 2013, ALROSA participated in a government auction to acquire licenses for exploration and mining of alluvial deposits in Western Yakutia located in close proximity to existing mining facilities. The licenses cost us RUB 130 million whereas the total reserves and resources for both fields amounts to close 1.1 million carats by Russian standards. We expect average annual production in the mid-term perspective to reach 200,000 carats per annum. Development of these two fields will not require significant capital investment.

In June the Company held the Annual General Meeting where the shareholders approved record dividends for 2012 in the amount of RUB 8.2 billion, which is about 25% of net income under IFRS and dividend per share is RUB 1.11. The shareholders also elected new Supervisory Board. 5 out of 15 its members are independent directors according to Russian statutes.

Now let's consider sales and marketing. In August this year ALROSA, together with the Shanghai Diamond Exchange (SDE), held an auction for rough and polished diamonds. This auction was held within a framework agreement signed by the Company and SDE back in April this year. Even though the volume of the sale was relatively small, less than $1 million, we still believe this to be a very important step in developing our position in one of the most prospective sales markets for diamonds.

Now a few words about the non-core assets. In September ALROSA commissioned an integrated gas treatment plant at its gas assets that has a capacity of 1 billion cubic metres of gas. Thus, our total capacity for gas assets has been increased twofold to reach 2 billion cubic metres of gas per annum.

Now please direct your attention to page 4. It explains our financial results for the first six months. Our revenue in the first six months of this year reached RUB 82 billion, which is 9% higher YoY. Two drivers behind this growth include production and positive development of the diamond market in Q2 2013.

Our cost of sales is up by 17% for the first six months YoY mainly driven by higher sales volumes. There is also negative pressure on costs through the rise of fuel and energy tariffs.

Despite the cost inflation, we managed to keep our EBITDA flat YoY. The EBITDA margin is still more than acceptable.

The total debt is up to reach RUB 142 billion due to the acquisition of the alluvial diamond producer Nizhne-Lenskoye, which has resulted in higher interest payments. Driven by higher interest payments and weakened rouble, the net profit for the first six months of 2013 is 10% down YoY.

I would like to note specifically the significant increase of our net profit in Q2 2013, which is nearly 2.5 times higher than last year. This growth comes thanks to, amongst other things, the implementation of our divestment strategy for the non-core assets since we sold 51% share of Timir in Q2 2013.

Now please proceed to page 5 for our sales overview. In the first six months of 2013 the situation in the diamond market has seen some positive developments with an average 7% price growth since the beginning of the year. Nevertheless the general pricing in the diamond market is still below last year's.

Our diamond revenue in Q2 2013 was 5% higher vis-à-vis Q2 2012, driven by higher sales volumes, which was an offset to the low prices.

Looking at the first six months of this year, our total revenue from diamond sales reached RUB 74 billion, which is higher as compared to H1 2012 as well as H2 2012 by 5% and 12% respectively.

Even with the lower pricing environment as compared to last year, we still managed to increase our revenue thanks to higher sales volumes in carat terms.

Now let's proceed to the next page number 6, which is the cost of sales revenue. The cost of sales reached RUB 39.6 billion, which is 17% up YoY. This growth was mainly driven by higher sales volumes in carat terms, which is up by 11%.

Wages, salaries and other staff costs increased by 10% vis-à-vis H1 2013 as a result of production growth and indexation of wages to inflation.

Higher fuel and energy expenses, which reached RUB 6.3 billion in the first half of this year, are related to higher tariffs for fuel and energy.

MET expense growth by 17% is explained by higher production volumes YoY as well as a stronger dollar.

Please note increased volume of maintenance work carried out by the Company and fewer services provided by contractors. The effect of this is lower services costs by 40% and higher material expenses by 29% YoY. The growth of materials is also explained by higher material costs.

Let's proceed to page 7, net profit overview. It explains key drivers behind net profit fluctuations in 2013.

As you can see from the page in the first six months this year we see pretty much all parameters are in line with last year's. The only difference is about financial expense, interest payments and FX difference, which have resulted in lower net profit for the first six months of this year.

In Q2 this year we see a reverse trend with the lower FX loss, which is a positive driver for the net profit. Also please note extra profits we received from the sale of Timir in Q2 2013. These two factors have resulted in growth by a 2.4 times YoY.

Let's proceed to page 8, our investment program and capex. Our total capex volume is up to reach RUB 14.9 billion, which is fully in line with the capex plan. Our maintenance costs for the first six months of 2013 reached RUB 7.5 billion, fully in line with the depreciation costs.

Growth of expansion capex by 22% is explained by developing the Udachny underground mine where we keep working on the overground facilities as well as keep constructing the emergency exits from the underground mine. If you consider Severalmaz, here we continue the expansion of the processing plant's capacity and construction of the tailings facility as well as housing for the shift workers and start of stripping operations at Karpinsky-1 pipe. Investments into the gas assets are explained first and foremost by the continued construction of the integrated gas treatment plant. Mir underground mine saw modernisation of its water removal infrastructure and continued mining of tunnels in the deeper levels. Lower investment into Aikhal underground mine is explained by the fact it has reached the designed capacity of 0.5 million tonnes per annum, which happened in April this year. The remaining investments we had were targeted for finalising construction works at the overground facilities.

Please flip over to page 9, debt portfolio structure. In Q2 2013 our total debt increased to $4.3 billion following the acquisition of the alluvial diamond producer Nizhne-Lenskoye.

In June ALROSA started early payment of the 2010 rouble bond with a total amount of RUB 16 billion. For this we allocated short-term debt for the same amount. This transaction was to streamline the debt portfolio and prepare it for reduction following the divestment from gas assets coming this year.

Thank you for your attention. Now my colleagues and myself are ready to take your questions.

Questions and Answers

Emmy Al-Ghabra – *UBS*

Hi and thanks very much for the presentation. Just a couple of questions from me. If you could please give us an update on the situation with the sale of your gas assets. If you have any timeframe that would be very helpful. Also could you please give us an update on your production and capex guidance for the full year and, if you have any for 2014 that would also be helpful. Thank you.

Igor Kulichik (translated)

As to the situation with the gas assets, it is no secret that we are now finalising the transaction to sell the gas assets. Given the complexity of the transaction, which includes the sale of four oil and gas fields – actually these four fields include two of the fields located in Urengoy and two in Yakutia – Irelyakhneft and ALROSA Gas. As you can understand, a transaction of this complexity needs a lot of approvals and calculations and we are now working with the buyer to finalise the size and the scope of this deal. I can assure you that it will have been completed by the end of this year.

As far as your request to give production and capex projections for 2013, regretfully, we cannot give guidance.

Emmy Al-Ghabra

Okay, thank you. Just going back to the sale of the gas assets, I think you gave guidance on a previous conference call that you are expecting to receive just over $1 billion for the sale. Can you confirm if that's still the size you are expecting and are you expecting to receive payment in cash? Thank you.

Igor Kulichik (translated)

Unfortunately, I cannot disclose details of this transaction but on a global level I think I can say that the deal size will exceed 1 billion and, yes, we would expect a cash settlement this year.

Kay Hope – *Bank of America Merrill Lynch*

Hello and thank you for the call. I have a few questions. I apologise, I was not on the call first couple of minutes. Have you given pricing outlook for the second half of the year in terms of diamond pricing or demand? Then a second question: you mentioned that you will be reducing debt with the sale of the gas assets. Can you give any sense of where you would like to see the debt end up or how much debt you intend to repay? Then, finally, can you give an update on the IPO?

Igor Kulichik (translated)

Let me comment on the diamond market first. As we commented earlier in the presentation, we see a growth at the level of 7% in the pricing environment since the beginning of this year. At the same time we don't expect a significant increase until year-end.

Now let me comment on debt reduction after the sale of the gas assets. We will direct all the proceeds from the divestment of non-core assets to reduce our debt burden. We are now finalising adjustments into our 2013 budget which incorporates the sale of gas assets already and, following that budget, we would expect the Group debt to be below $3 billion by the year-end.

As far as your question about the IPO is concerned, well, you can understand we are pretty much constrained by publicity guidelines but I can tell you that the initial plan of Rosimushchestvo, the Federal Government's Property Management Agency, and the Ministry of Property Management of Yakutia to sell down a 7% stake each are going to be fulfilled and we are going on with the deal as planned.

Kay Hope

That's very helpful, thank you. Can I ask one follow-up question? I believe that state companies are requested or strongly encouraged to pay out 25% of net income as dividends. If all proceeds from the sale are used for debt repayment, does that put you in a difficult position at the current level of debt for paying out that sort of a dividend or have I maybe misunderstood the process?

Igor Kulichik (translated)

Let me give a more general comment on the dividend policy first. As we understand this, Rosimushchestvo, the Property Management Agency on behalf of the Government, does request by its internal directive to pay out in dividends no less than 25% of IFRS net income and that's what we did this year, paying out dividends for 2012. The dividend policy now being reviewed by our Supervisory Board does contain the same provision, which means in the future we will be paying again no less than 25% of IFRS net income. Now let's consider particularly the funding source to pay the dividend. The cash flow which we currently generate allows us to continue with our investment plans and pay the dividends at the same time. The reduction of the debt burden and payment of the dividends are in no way related.

Sergei Donskoy – *Société Générale*

Hello and thank you. I have one small question. Could you please comment on your joint venture in Angola and Botswana? Do you already have some promising exploration targets there which you think could be developed into sizable operations going forward or it's all about finding some new sizable deposits and nothing of a significant size at this point? Thank you.

Igor Kulichik (translated)

We are currently working on establishing one exploration entity that will be looking into these assets in Angola and Botswana. What we are waiting currently on is about licensing. We need a universal licence for this entity to operate across the jurisdictions, which means that the new joint venture will start operations no earlier than in 2014. Since we are talking here about exploration efforts rather than anything else yet, the costs will be relatively low and we don't expect any significant capital expenditure in these jurisdictions for now.

Des Kilalea – *RBC*

Thank you. I wonder if you could expand on what you see from a jewellery perspective for China over the next 12 months. You do have an arrangement with a large retailer there. Maybe give us an indication of growth you expect from China.

Igor Kulichik (translated)

Actually, I would split the two issues and consider them separately. Our presence in China is one thing and our developments with the Shanghai Diamond Exchange on the other count. Our regular efforts with the Chinese buyers are developing with no surges as well as with our other clients. The volumes they are targeting are the same as throughout the first half of this year; therefore, that's a rather regular development. Whereas our cooperation with the Shanghai Diamond Exchange is more or less about the opportunity to become closer to the Chinese markets in order to understand better the structure and the pricing environment, the volumes of sales through the exchange will not drive significantly our volumes across China.

Stella Cridge – *Barclays*

Good afternoon. I was wondering if I could ask two questions. The first relates to production and I guess what you have shown us is that the production from some of your new mines has been more than offsetting the declines in some of your previously larger mines and I was just wondering if that's something that we should expect to continue. My second question relates to cost trends. I was wondering just if you can give us a broad idea of what to expect in costs over the next year and would you expect them to rise at the rate of inflation, for example, or perhaps a little more or a little less? That's all from me, thanks.

Igor Kulichik (translated)

Well, if looking at the dynamics during the year, any changes in production in any given field are temporary ones. If you have noticed, in particular, variation from one six months period to another, well, that is temporary again and, if you consider change in development, that comes only with conversion from overground to underground mining operations.

Considering our cost of sales, again there are two main drivers: higher sales volumes YoY that is up by 11% and higher fuel and energy tariffs.

I would like to thank all participants. Thank you for your attention and see you on the next call.