



АЛРОСА  ALROSA

# ALROSA 1H 2012 IFRS Results Conference Call Summary

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# Corporate Participants

## **Igor Kulichik**

*CFO – ALROSA*

## **Ayaal Golub**

*Head of Capital Markets – ALROSA*

## **Sergei Mezhokh**

*Capital Markets– ALROSA*

## **Anastasia Misharina**

*Head of IFRS– ALROSA*

# Presentation

## **Igor Kulichik**

Ladies and gentlemen, my name is Igor Kulichik. I am the Chief Financial Officer of ALROSA. On behalf of our team, I would like to welcome everyone on this call to present ALROSA's results for the first half of 2012. Let me start with a few matters of procedure. The results will be presented by myself, and Mr Ayaal Golub, Head of the Capital Markets department, Mrs Anastasia Misharina, Head of the IFRS Department, and Mr Sergei Mezhokh, member of the Capital Markets team. We will be delivering this presentation based on the slides available on our web-site. You can also access the presentation via the web-cast. At the end of the presentation, my colleagues and I will be happy to take your questions. I would like to begin with presenting the highlights of the first half of 2012. Please direct your attention to page number three.

Diamond production in the first half of 2012 has been reduced, as planned, by 15% vis-à-vis the first half of 2011. Nevertheless, full year numbers for 2012 will be back at the usual annual level of approximately 34.5 million carats. Our revenue increased by 16% in the first half of 2012 compared to the first half of 2011 due to higher prices on industrial and gem-quality diamonds. Cost of sales grew by 46%, driven by increased salaries and prices on fuel. As a result, EBITDA and EBITDA margin are in line with the first half of 2011 figures. Net profit decreased by 38% due to exchange losses from revaluation of dollar-denominated debt, resulting in the number of RUB 16.2 billion. The Company has a comfortable leverage of 2.1 total debt to EBITDA ratio with plans of bringing it down gradually. The debt breakdown will be explained later in the presentation.

I would like now to give the floor to Ayaal Golub, who will give you more details on our operational and financial performance.

## **Ayaal Golub**

Hello everyone, my name is Ayaal Golub and I will give you an update on our operations and financials. Please turn to page four of our presentation. In the first half of 2012, production totalled 16.4 million carats, which is 15% lower than in the corresponding period of 2011, as volumes of extracted ore at Udachniy pipe continued to go down due to the transition of open-pit operations to underground mining.

A few words on the performance by key operational units. Production at Nyurbinskaya pipe tapered off due to planned maintenance works at the processing plant. Increase in production at Jubilee pipe in the first half of 2012 was driven by planned processing of higher quality ore. Overall production was sustained by increased output from Mir and Aikhal underground mines.

Now, a few words on sales, let's turn to slide five. In the first half of 2012, diamond revenues reached RUB 70.5 billion, which represents a 16% increase over the first half of 2011. The increase was driven by higher prices. In gem-quality segment, prices went up 11% compared to the first half of 2011, and reached \$195 per carat, while sales volumes remained flat. In non gem-quality diamonds sector, prices increased 77% compared to the first half of 2011 and reached \$10 per carat, that allowed us to get \$56 million revenue from sales of non gem-quality diamonds, which is a 40% increase to the first half of 2011.

Let's continue with the cost of sales review on slide six. Our implied production costs grew 28% compared to the first half of 2011 from RUB 29 billion to RUB 37 billion. This growth was mostly driven by a planned increase of compensation expenses of personnel, which occurred in the fourth quarter of 2011, and higher expenses on fuel. In particular, an average salary in the Company grew 42% compared to the corresponding period in 2011 and added RUB 3 billion to our cost of sales. As for fuel and energy expenses, this growth has been driven mainly by 18% increase in prices on fuel.

Let's move to investment program and capex, slide seven, please. Total capex for the Company reached almost RUB 14 billion in the first half of 2012, which is a 59% increase to the first half of 2011. Expansion to capex growth was dominated by investments to construction of underground mine at Udachniy, ramp-up of production capacities at Severalmaz and investment to gas assets. It is worth mentioning that we started development of our gas assets. Today, around 50 kilometres of pipeline have already been built. It is expected that a pipeline's plug-in complex will be finished by November 2012, enabling the Geotransgaz' pipeline to be connected to Gazprom's. That will allow us to start selling gas. As for maintenance expenses in the first half of 2012, they grew 46% due to increased expenditure on maintenance and reconstruction of production facilities.

Moving to our debt portfolio, slide eight, please. As it was mentioned earlier, in the first quarter of 2012 we raised approximately \$1.3 billion in ECP to repurchase gas assets. As papers are nominated in US dollars, we can see some fluctuations in our rouble based balance sheet, as rouble fluctuates against dollar. As a result, our leverage increased to 2.1 times. We believe that this is a comfortable level for us and plan to reduce our leverage after selling gas assets. I also want to share with you some most recent information on our debt

portfolio, as some time has passed since the half year end. Our total debt as of October 2012 stands at \$4.3 million and average interest rate across our portfolio is 6.3%. As for the short-term debt, ALROSA is on track to refinance it by bank loans and public debt instruments. With that, let us open the session for your questions.

## Questions and Answers

**Des Kilalea** – *RBC, London*

A couple of questions: could you comment on what you expect for rough diamond prices, gem diamond prices for the second six months and could you remind us whether you are selling everything or is some of it going, at the moment, back to the Treasury? Finally, ALROSA, I think, has a medium-term target of growing in production to around 38 million carats. Is that still the medium-term production target?

**Sergei Mezhokh**

As for our prices, our estimation for the whole 2012 is that we will be able to achieve average price growth of 2% compared to the whole year of 2011. As for our sales to the State Treasury of precious metals, we have already sold \$91 million of rough diamonds in the first half of 2012, and that has been done to support the market. And as for our longstanding production plan, we expect increase to 40 million carats in medium-term and our production target for 2012 is approximately 34.5 million carats.

**Sergei Donskoy** – *Société Générale, Moscow*

I have three questions, if I may. Firstly, could you provide please your capex guidance for the year and, and, if possible, some estimate for the next year? A second question, there was quite meaningful increase in your working capital during first half of the year. I think that you invested in total around RUB 12 billion in inventories and receivables. What was behind that? Was it a seasonal effect? Do you plan this working capital to be released and when? Thirdly, you mentioned a very substantial 40% increase in salary year-over-year. Could you comment on what was the reason for such a significant one-time salary increase for the Group? Thank you.

**Sergei Mezhokh**

As for our capex guidelines for this year and the next year, it is about RUB 30 billion. We expect it to decrease in 2015, when we will complete our major investments to Severalmaz. As for our salaries increase, this happened one time last year. This was an indexation of our salaries at 40% and we do not expect this to happen at this rate further. Regarding your question about working capital, I will pass it to Anastasia Misharina.

**Anastasia Misharina**

Yes, you are right, our working capital has increased, as for the end of the first half 2012; and this is mainly due to the seasonality of our business. As you might know, we supply goods and materials to the Northern region and this year it happened mainly in the second quarter, so if you look at the balance sheet you will see that the main increase comes through accounts receivable and advances, which is to be resolved by the end of the year. So you will see at the end of the third quarter and by the end of the year, that working capital increase will go down.

**Oleg Petropavlovskiy – BCS, Moscow**

I have just a couple of question on your assets. Could you please elaborate on the Nizhne-Lenskoye deal and the possible deal of selling gas assets?

**Igor Kulichik**

Let me start with the second part of your question relating to the gas assets. We reconfirm our intent to sell the two gas fields and thus completely divest from the gas business. In the coming six to eight weeks, Geotransgaz will be connected to Gazprom's gas transportation system and it will start gas sales. Geotransgaz will migrate from an asset holder into a gas selling company. Alongside with actively developing the two gas assets, we are negotiating with potential buyers. Currently, there are four potential buyers involved.

I cannot tell you when we can sign a deal with one of them, but there is certain probability the deal could happen this year; however, it is more likely it will be 2013. Let me reiterate though that our strategic decision to divest from the gas business remains unchanged. We are completely focused on the core business and planning to withdraw from the non-core activities.

Now let me comment on Nizhne-Lenskoye. We are not hiding our interest towards it. We have notified the Government of Yakutia of ALROSA's intent to participate in the privatization of this company should it happen. We have also applied to the Federal Anti-Monopoly Service of Russia for their clearance to acquire 100% of Nizhne-Lenskoye stake by two ALROSA's companies. We have received clearance from the Anti-Monopoly Service for both of our subsidiaries and now the decision is pending from the Government of Yakutia. They have to decide on the particular form of the privatization process, the timeline, the valuation and they have to come up with a starting price. Currently all of these are pending. As soon as there is specific information on the format we will be deciding generally how we are going to participate.

**Alexander Morin – Sovlink, Moscow**

Good afternoon I have a few questions about debt structure. Do you plan to buy short-term loans to cover it in the current year? If you refinance debt, can you clarify debt for the future year?

**Ayaal Golub**

We're not planning to raise any short-term debt to repay the portion of debt to be maturing in the fourth quarter of the current year. In the fourth quarter the amount of debt to be repaid amounted to \$1.7 billion out of which the Company is planning to refinance up to \$1.3-1.4 billion and the Company is on track to refund it by bank loans and rouble denominated bonds. This new debt is going to be long-term.

**Alexander Sklemin – Raiffeisen Bank, Vienna**

Many thanks for your presentation, brief clarifying questions on your refinancing option. Although you have actually stated that you plan to refinance the short-term debt with a bank loan and with rouble papers, do you actually plan to issue any Eurobonds in the near future? Considering the recent placement of NLMK or the current placement of Severstal, it seems that ALROSA could acquire some ten-year money for a fairly tightly priced trade.

**Ayaal Golub**

We consider a number of instruments to refinance this debt, and took a decision that these two instruments which are a bank loan and rouble denominated bonds fit the interest of the Company most, taking into account diversification of our debt portfolio. As to this rouble denominated bonds, this instrument is easy to arrange and the situation on the rouble bond market make us decide that this is the instrument that fits our interest.

**Alexander Sklemin**

Many thanks, then maybe you can briefly comment on the potential bank loan. Is it going to be rouble denominated or foreign currency denominated, just to get the feeling of your debt currency structure?

**Ayaal Golub**

Bank loan is going to be dollar denominated.

**Erik Danemar – Deutsche Bank, Moscow**

A few follow up questions, most of my questions have been answered already actually. I wonder, you did comment on what your expectation for prices are for the year on average. Could you maybe give some colour on the pricing that you see in the market at the moment both in terms of rough gem-quality and industrial? That is my first question. The second question which I believe a previous person asked on the call also, in terms of production you have given guidance for the year. Should we expect sales volume to match that production or do you expect there to be movements in inventory? Thirdly, maybe you could also provide some more colour on your potential sale of the gas assets. Are you looking at still selling half or are you looking at trying to sell the full asset? Lastly, just on the sale of Timir, when you expect that to formally and finally close in terms of cash inflow, and also when you could potentially see the first capex going into that project? Thank you very much.

**Sergei Mezhokh**

Thank you Erik for your questions. As for prices we were able to achieve by our expected results of nine months of 2012, we see gem diamond prices staying almost at the level of the previous year and non-gem prices going up to 20%.

As to your question about production volumes matching sales volumes, by the results of 2012 our expectations as of today are that these volumes will match and there will be no significant movements in inventory.

As for your question about gas assets, we plan to sell 100% of them. Regarding the deal with Timir, our expectations are that this deal will be closed this year and hopefully we will see cash inflow this year as well.

**Denis Gabrielik – Otkritie Capital, Moscow**

I have one question regarding gas assets. Can you give us some kind of capex guidance for your gas assets, how much you plan to spend this year and probably in 2013 on the development of gas assets?

**Igor Kulichik**

The capex plan for both assets is at about RUB 12.5 billion, but the program is very flexible, it allows if needed to speed up or alternatively delay gas production and development. Given now negotiations with potential buyers, we are not trying to foster our gas assets capex.

**Kay Hope – Bank of America Merrill Lynch, London**

I was a little bit late to the call so hopefully I am not asking questions that are repetitive, I apologise. You talked about the refinancing plans for debt due in the fourth quarter. You have \$300 million due I believe in the first quarter of 2013 and I wondered how that might be dealt with? Then separately I am wondering if you have had any changes to your contracts, either your long-term contracts or your short-term contracts, and if so what have those changes been?

**Ayaal Golub**

\$300 million debt is maturing in the first quarter of 2013, and we are planning to refinance it, most probably it will be a rollover of ECP. We are aiming to keep our debt portfolio as flexible as possible.

**Sergei Mezhokh**

As for the number of long-term contracts and the split between the long-term and short-term contracts, no significant changes have happened in terms of structure. We expect around 70% of our sales to be done through long-term contracts and the good news is that we increased the number of long-term clients from 24 to 32.

**Kay Hope**

Terrific, have there been any changes in the terms on those contracts? I know that there have been some diamond producers who are allowing off-takers to delay their off-take for some amount of time. Are you seeing that in your market as well?

**Sergei Mezhokh**

Yes, we did this during summer. Summer is traditionally a weak season for diamond sales so we implemented such measures, but we do not implement them anymore.

**Des Kilalea – RBC, London**

Well, you have in the past given a split of your sales as to contract and spot sales. Would it be possible to get that split for the first half of 2012?

**Sergei Mezhokh**

There have been no significant changes. In the first half of 2012, roughly 70% of our sales were through long-term contracts and the rest have been split between spot sales and auctions.

**Farangiz Rahimova – BNP Paribas, London**

Thanks a lot for the presentation, just a quick question on FX hedges, specifically I was wondering since your results were so significantly impacted by FX fluctuations, is there any plan in the future to put on some FX hedges? Thank you.

**Ayaal Golub**

Yes, we considered to set up a program to hedge our currency fluctuations. This will happen in the next year.

**Ayaal Golub**

Thank you very much, ladies and gentlemen. If you have any further questions please feel free to contact our IR-Department at [IR@alrosa.ru](mailto:IR@alrosa.ru).