# ALROSA 9M and 3Q 2012 IFRS Results

## Conference Call Summary

4th December, 2012

# Corporate Participants

**Igor Kulichik**

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**Ayaal Golub**

*Head of Capital Markets – ALROSA*

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**Anastasia Misharina**

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# 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 dedicated to ALROSA's results for nine months and the third quarter of 2012. The results will be presented by myself, Ayaal Golub, Head of the Capital Markets Department, Anastasia Misharina, Head of the IFRS Department, and Sergei Mezhokh, member of the Capital Markets team.

I would like to start with presenting our key results for nine months and the third quarter of 2012. Please kindly direct your attention to slide number three. Diamond production of the Company over nine months 2012 resulted in 25.4 million carats which is in line with nine months 2011, the sustainable level comes after planned ramp up of production in the third quarter by 32% year-on-year. Nine months 2012 sales volumes decreased by 21% compared to nine months 2011 explained by weaker demand in the third quarter of this year. Nine months 2012 revenue is in line with nine months 2011 figures resulting in a number of RUB 104 billion and not demonstrating growth due to weaker sales of diamonds in the third quarter of 2012 compared to the second quarter of this year. Cost of sales in nine months 2012 grew 24% compared to nine months 2011, driven by higher expenses on materials, increased depreciation and planned increase in salaries which occurred in the fourth quarter of 2011. This resulted in the Company's EBITDA decreasing by 17% with the EBITDA margin staying above 45%. Nine months 2012 capex increased by 51% to nine months 2011, mostly invested to the following assets: processing plant and tailings facility at “Severalmaz”, then construction of infrastructure at underground mine “Udachniy” and integrated gas processing plant for our gas assets. In the third quarter of this year total debt to EBITDA ratio increased to 2.5 times due to decreased EBITDA. By the end of 2012 we are planning to get back to the leverage of 2 through lower debt and sales growth.

Thank you and I would like now to give the floor to Ayaal, who is going to explain our operational and financial performance in more detail.

**Ayaal Golub**

Good afternoon everyone, I will give you an update on our operations and financials. Please turn to page four of our presentation. In the third quarter of 2012, production totaled 9.1 million carats which represented a 31% increase to the same quarter of 2011. Such an increase is in line with the Company's production plans for the year.

A few words on the performance by key operational units. Production at Nyurbinskaya pipe in the third quarter of 2012 – our main production growth driver at that period – was up 50% compared to the second quarter of the year due to recommencement of ore processing at the processing plant after completion of planned maintenance works. Production at Aikhal underground mine tripled in the third quarter of 2012 compared to the third quarter of 2011 and doubled compared to the second quarter of 2012 and is expected to reach target production levels soon. Production at Jubilee pipe continued to grow due to processing of higher quality ore according to the plan. Continuous transition of open-pit operations to underground mining at Udachniy pipe resulted in further production reductions. Ore from Zarnitsa pipe was not processed in the third quarter of 2012 due to planned annual maintenance works at the processing plant.

Now, a few words on sales. Please turn to slide five. Nine months 2012 diamond revenue equaled RUB 93.8 billion, which was 4% lower than in nine months 2011. This change was driven by 34% decrease in diamond sales in the third quarter of 2012 compared to the second quarter of 2012. In the third quarter of 2012, achieved gem-quality diamond prices were down 9% compared to the third quarter of 2011 influenced by weaker demand. However, nine months 2012 gem-quality diamond prices were 4% higher than nine months 2011 prices and reached around $200 per carat, being supported by reduction of sales volumes in the third quarter of this year. Meanwhile, prices for non gem-quality diamonds decreased by 27% in the third quarter of 2012 to the third quarter of 2011 due to shifts in product mix and equaled $10 per carat. Although we are concentrated on gem-quality diamond sales, sales of non gem-quality diamonds allowed us to get extra revenue of approximately $70 million in nine months 2012, which generated 2% of diamond revenue.

Let's continue with cost of sales review on slide six. Our implied production costs grew 27% in nine months 2012 as compared to the corresponding period of previous year, from RUB 43 billion to RUB 55 billion. This growth was mostly driven by planned increase of compensation expenses of personnel which occurred in the fourth quarter of 2011, increased depreciation, and higher expenses on fuel and materials.

Let's move to investment program and capex – slide seven, please. Total capex for the Company reached RUB 21 billion in nine months 2012, which is a 51% increase to nine months 2011 driven by almost doubled expansion capex and 26% increase in maintenance as well. Expansion capex growth was dominated by advancement of investments to processing plant and tailings facility construction at "Severalmaz", to continuous construction of underground mine at Udachniy and to gas assets, in particular to construction of integrated gas processing plant. As for maintenance expenses, nine months 2012 maintenance capex was 26% higher compared to nine months 2011 according to the Company's plan.

Moving to our debt portfolio – slide eight, please. In the third quarter of 2012, total debt to EBITDA ratio increased to 2.5 times from 2.1 times in the second quarter of 2012 due to decreased EBITDA and allocation of a short-term loan from Alfa Bank of $350 million to fund ongoing Company's needs. This short-term debt was redeemed in October 2012. I also want to share with you some most recent information on our debt portfolio as some time has passed since the end of nine months 2012 period. Our total debt as of December 2012 stands at $4,358 million[1] and average interest rate across our portfolio is 6.8%[2]. By the end of this year we plan to decrease our debt to approximately $3.8 billion, which will allow us to deleverage to 2.0 area. With that let us open the session for your questions.

# Questions and Answers

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

Good evening and hello everyone. Thank you for the presentation, I have three short questions if I may. Firstly, on your production plans and sales, in the third quarter you increased production of diamonds in carats by approximately 10% while sales dropped by about 34% which as I understand was the main reason behind another increase in your inventories which went up by about 100% quarter-on-quarter. The question is – Do you plan to somehow adjust your production schedule for the fourth quarter given this increase in inventories? Do you plan to somehow adjust production plans for the next year, and how does the outlook for your sales and distribution look like right now for the near term?

My second question is about G&A. In the third quarter there was a meaningful drop in G&A expenses by about 44%, which was as I understand driven both by decline in staff costs, and services and admin expenses. Is this sustainable or should we expect the G&A costs to go back to the level of RUB 2.5 billion as in the first and second quarters?

Thirdly, going back to the inventory question, what is your plan for the accumulated inventories of diamonds at this point, and how big are they approximately relative to your annual production? Thank you.

**Sergei Mezhokh**

Sergei, good day. As for our production plan for 2012, it remains unchanged. Our production for 2012 is expected to be at the level of 34.4 million carats. As for our sales, they will keep up with the production level. Regarding the current situation with the market and diamond prices, prices stayed lower compared to the first half of 2012 as it was stated earlier; overall, we saw strong prices in the first half of this year and softer prices in the second half of the year. For the whole year of 2012 we will see average diamond prices at the level of 2011.

[1] When using USD/RUB exchange rate on 04.12.2012 for rouble bonds, total debt equals $4,358 million as opposed to $4,341 million told on the call
[2] During the call an average interest rate was announced to be 6.16%. However, an updated figure for December is 6.8%

As for inventories that we accumulated, they are around 20% of our annual production which is quite a reasonable level for us to offer sufficient variety of diamonds to our clients. And our plan regarding these inventories is to adjust to the current market situation. As we see it, lower diamond prices today are healthier for the market and healthier for our clients. And I will pass the next question about expenses to Anastasia Misharina.

**Anastasia Misharina**

As for the general expenses, there is some inconsistency between quarters. This is because the second quarter was the quarter when the bonuses of the management were paid after they were approved by the annual general meeting. Therefore, the second quarter was a bit higher than usual, but the third quarter in terms of general expenses is at normal levels.

**Des Kilalea** – *RBC, London*

A couple of questions, one to follow the previous question. Do I understand that your inventories are about 20% of annual production and do those inventories include what may be held with the Gokhran? And also could you give us an indication of what you expect for demand and prices next year, the first half anyway? Thanks.

**Sergei Mezhokh**

Nice to hear you, Des. As for your question about our inventories, of course they do not include inventories which are held by Gokhran, which is completely independent from ALROSA. In regards to our short-term outlook for diamond prices, again we can see the current level of pricing in the diamond market to be comfortable both for diamond producers and for our major clients. We do not expect significant changes in the upcoming quarters of 2013. Of course, it much depends on the jewelry sales which will happen in December. Thank you.

**Tala Boulos –** *Deutsche Bank, London*

Good afternoon everyone, I just have a couple of questions. The first one – you mentioned that you plan to bring total debt down to $3.8 billion by the end of the year. Can you maybe elaborate a little bit on how you intend to do that? I know you have obviously about a billion in ECP debt due over the next few months. If you can just give us some clarity on that. My second question is – Can you give us an update on the status of the gas assets?

**Ayaal Golub**

According to ALROSA debt repayment schedule, ALROSA is to repay $700 million ECP issue in December. This is going to be partially refinanced by bank credit facility at the amount of $200 million. The rest amount should be repaid from our own cash. Currently cash balance is about $250 million, so the rest amount is to be collected.

As to your second question about gas assets, nothing special happened in the course of the last three months. We are still in the process of negotiations with three potential buyers of those assets and next week we are inaugurating the launch of gas pipe belonging to Geotransgaz and starting to produce gas.

**Kathleen Middlemiss –** *UBS, London*

Can you just reiterate your capex guidance for the full year 2012 and next year and can you also break it down to what percentage is maintenance or what portion will be maintenance if that has changed at all?

**Sergei Mezhokh**

Thank you for your question. Our capex guidance for 2012 remains unchanged. It will stay at the level of RUB 30 billion. We do not expect significant changes in our capex in the next year, and the split between maintenance and expansion would be that roughly RUB 14 billion will be maintenance capex and the rest will be expansion.

**Dinnur Galikhanov –** *Aton, Moscow*

Good afternoon. I have two question related to the sale of 50% stake in Nizhne-Lenskoye that was recently announced by the Government of Yakutia. Firstly, do you still have plans to participate in the auction for that asset? And secondly, why in your opinion they are selling just 51%, not the whole stake in the company?

**Sergei Mezhokh**

Thank you for your questions. Yes, we are going to participate in the auction which will be held by Republic of Sakha (Yakutia) to acquire 51% of Nizhne-Lenskoye. We consider this asset as interesting for us and we see a lot of synergies of this asset with our existing diamond production in this region but, of course, it will be an auction, there will be other participants as well so we will see… Regarding the reason why this is not a sale of 100% shares, it is more a question to the Republic of Yakutia which is currently the owner of this asset.

**Alexander Sklemin –** *Raiffeisen Bank, Vienna*

Thanks for your presentation, two follow-ups from me, first of all on the total debt reduction in the fourth quarter. You mentioned that you actually plan to use your own cash for that and partially a loan facility. As far as I understand you have recently borrowed about $600 million from VTB and about $300 million in the domestic bond placement which means that you have acquired $900 million in cash. Does your statement about your own cash mean that you plan to generate free cash flow in the fourth quarter of this year, something like in the amount of $500 million or does this mean that you actually plan to use this particular credit to repay your short term debt? The second question is also a follow-up on your gas assets. How is it going with investing in these assets? As in your presentation I see that you have started investing in the gas plants. Are you planning to boost your investments in these gas assets or do you still plan to sell them without investing that much in them?

**Ayaal Golub**

That $600 million bank loan that we raised in October was directed to refinance the existing debt at that time. You are right, currently we are generating our own cash and expect to generate more cash in the course of December to be used to repay the debt.

**Sergei Mezhokh**

As for the gas assets, our capex to gas assets this year would be at the level of RUB 4 billion. We accelerated investment in these assets solely to make them more attractive to potential investors. And as it was said today, we are in negotiations with three potential buyers, and depending on the results of these negotiations we will decide on certain investments.

**Des Kilalea** – *RBC, London*

A couple of follow-up questions again on sales. You have sales contracts I think with Tiffany and Chow Tai Fook. I wonder if you can give an idea what your strategy is on contracts and how they are to be split between deals with retailers or deals with your other customers. And also if you can just update whether you sold any rough to the Treasury this year.

**Sergei Mezhokh**

Thank you for your questions, Des. Starting from the end of this year we sold around $90 million of rough diamonds to Gokhran (or the Treasury). And as for our new contracts with our new long-term clients, it is part of our strategy which states that roughly 70% of our sales should be done through our long-term contracts. By following this strategy we aim to increase the amount of our long-term clients and mostly concentrate on those who have their own polishing facilities and who also sell diamonds for jewelry. And of course we appreciate and welcome such well-known names as Tiffany and Chow Tai Fook among our clients. Thank you.

**Kiti Pantskhava –** *VTB Capital, Moscow*

I have a follow-up question with regard to your production and sales numbers. You are telling that your production guidance at 34.4 million carats is unchanged and sales volumes will meet the same number, so it seems to me on your first nine month performance results that means you will continue to accumulate inventory in the fourth quarter. Is that right?

**Sergei Mezhokh**

The main difference between the third and the fourth quarters is that in the third quarter of 2012 we supported diamond strategy by reducing our sales volumes. And as of today, we adjusted our prices to meet current market demand, made them lower which meets the needs of our clients. And by doing this we will bring back our sales volumes in carats; and therefore, by the end of the year our sales volumes will almost meet our production volumes.

**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.