ALROSA FY 2013 IFRS Results

Conference Call Summary

15 April 2014

ALROSA speakers

Ilya Ryashchin – *First Vice President*

Igor Kulichik – *Chief Financial Officer*

Anastasia Misharina – *Head of IFRS Reporting*

Sergei Mezhokh – *Head of Investor Relations, Foreign Affairs and Analytics*

Participants asking questions

Dmitriy Kolomytsyn – *Morgan Stanley*

Yulia Chekumaeva – *Goldman Sachs*

Yuri Vlasov – *J.P. Morgan*

Vadim Astapovich – *VTB Capital*

Andrey Lobazov – *Bank of America*

Des Kilalea – *RBC*

Mariya Gancheva – *Mitsubishi*

Sergey Donskoy – *Societe Generale*

Presentation

Sergei Mezhokh

Good day, welcome to ALROSA conference call on 2013 results. I am Sergei Mezhokh, Head of IR, and I will make a few introductory notes. We have on the call today Ilya Ryashchin, First Vice President, Igor Kulichik, CFO, Anastasia Misharina, Head of IFRS Reporting, and myself. We have prepared several slides for you which are uploaded to the IR section of ALROSA's website and emailed to you earlier. We would refer to them while making the presentation.

Before we start, as usual, I would like to remind you that some information which we provide during this call today may include forward-looking statements that involve certain risks, uncertainties and assumptions. If these risks or uncertainties ever materialize or the assumptions prove to be incorrect, our results may differ materially from those expressed or implied by such statements. ALROSA assumes no obligation and does not intend to update any such forward-looking statements. Now, I pass a word to Ilya Ryashchin. Please.

Ilya Ryashchin (translated)

Good afternoon, ladies and gentlemen! On behalf of ALROSA, I am happy to welcome you on our FY 2013 conference call and I would like to thank you for your attention.

In 2013, ALROSA's revenue grew 12% and amounted to RUB 168.5bn, i.e. above USD 5bn for the first time ever. Our sales volumes in carats were up 15% y-o-y due to active sales from stock.

Our EBITDA was up 12% to reach RUB 69bn, with ALROSA being able to keep margins high, i.e. at 41%. Net profit dropped, however, by 5% due to partial revaluation of USD-denominated debt portfolio following the rouble's weakening during 2013. The amount of such revaluations stands at over RUB 6bn.

An obviously positive impact was the growth in free cash flow of almost 29% driven by expanded core operations income and reduced working capital investments.

In 2013, we delivered sales of about RUB 18bn more than in 2012, mainly due to diamond and polished diamond sales increased by RUB 13bn. So, our revenues boosted by about 12%.

Another revenue growth driver having crystallized in 2013 is worth mentioning here, which is natural gas asset launch in Urengoy. Sales of natural gas from those assets contributed about RUB 5.5bn into our revenue.

In our rough diamond segment, the revenue added RUB 13.4bn, mainly through larger sales volumes and, to a lesser extent, the weakened rouble.

Unfortunately, our average price of gem-quality rough diamonds in 2013 per carat stayed 9% below 2012 on the back of the following two factors.

Out of the 9% in the average ticket dip, 4% was due to a softer market. In 2013, we saw no annual price growth, although, we had expected it before. The other 5% of the price dip was due to sales mix movements.

It is also important, that we strategically sell not just new production, but also diamonds from stock. In 2013, we sold over 1mln carats more than we produced to boost revenues even in softer markets.

Please, see slide 7 for our cost growth analysis. You can see an uptrend in both production and sales costs, by 12% and 19%, respectively. This cost growth was driven by increased diamond production and other operations. However, in like-for-like terms, the growth in costs was within the inflation rate.

Slide 8 shows our costs broken down by item for 2013. Principally, we see no material change there. Payroll of 40% of costs is still in the lead, compensations and benefits being up y-o-y on the back of expanded production and salary indexation to meet inflation rates. And, certainly, another important driver here is the acquisition of the Nizhne-Lenskoe mining company.

As to depreciation charges, they grew by 16% mainly due to new equipment coming on-stream at the Udachny Mining and Processing Division. Fuel and energy spend was 5% up through intensified mining and inflation processes. The Mineral Extraction Tax expense was higher due to increased valuation of diamonds. And, certainly, it is worth mentioning that we launched natural gas production at our gas assets. Back in 2012, we recognized no expenses for those assets.

As to the MET, in Q1 2013, the diamond production tax base was increased by 35% to deliver extra budgetary income for Yakutia. So, in 2014 ALROSA will pay about RUB 1.5bn more in MET, but this extra spend will be offset by housing maintenance reimbursement from Yakutia. And this extra spend has already been budgeted for 2014.

A y-o-y positive trend is noteworthy in other income and expense. Net other income is still negative, however, this negative impact is smaller than last year. An important positive driver here is extra income generated by the sale of shares in Timir and lowered social costs.

Our social spending dip in 2013 was primarily driven by the high baseline effect of 2012, since that spending was provisioned back in 2012 as prepaid expenses based on our agreements with the Republic of Yakutia. On a like-for-like basis, however, ALROSA's expenses for local infrastructure maintenance and other social expenses were 4% up.

Talking about EBITDA, I would like to highlight an uptrend here, this metric being up 12% y-o-y, and, more importantly, we managed to keep EBITDA margin at the last year's level, i.e. 41%. So, we are happy to deliver over and above our commitments.

Our exploration expenses grew for objective reasons, like increasing mining and obtaining extra licences together with Nizhne-Lenskoe acquisition. General and administrative expenses were up due to salary indexation and higher other expenses, including automation expenses. That said, however, the expenses stayed flat versus 2012, i.e. at 7% of the revenue.

Our financial income and expenses were negatively affected by the weakened rouble putting both downward pressure on financial income (through reduced FX gains) and upward pressure on financial expenses (larger FX losses). The total amount of currency exchange revaluations stood at above RUB 6bn.

As to our interest expenses, they grew both through increased spending on an expanded loan portfolio and higher interest expense caused by the revaluation of pension liabilities.

ALROSA's net profit was 5% down y-o-y. Unfortunately, the negative impact of currency translation differences did offset positive net profit drivers, in particular, EBITDA growth.

Our Capex were 27% up y-o-y, mainly driven by a larger maintenance and upgrade component along with continued implementation of our three core projects. These projects include the construction of the Udachny underground mine, Severalmaz processing plant in the city of Arkhangelsk and Botuobinskaya open-pit mine.

Talking about our Capex, I would like just to remind you that before we gave guidance on 2013 Capex to stand at RUB 33–34bn. However, in fact, we spent about RUB 38bn. This increase was mostly driven by accelerated implementation of certain projects and by an office building purchase in Moscow to have all our people on one venue. Certainly, in the course of time we are going to be selling our established real estate to partly offset the price of this building. However, it may happen only in 2015 or 2016.

Now, let me talk a bit about such important metrics as working capital and cash flow. You can see some improvements here. In particular, we managed to reduce our working capital needs as we stopped pre-payment practices under new contracts and worked actively to extend payment time limits under established contracts. Besides, we have started paying special attention to diamond inventory management, to active sales from stock, which helped us reduce investment in inventory change by about RUB 5bn.

Reduced working capital investment along with increased operations income became one of the two key enablers of cash inflow expansion of nearly 30% in 2013.

As to our loan portfolio, I can say that a deleveraging trend is noteworthy and obvious. As at the end of Q1 2014, the debt is USD 3.8bn versus USD 4.1bn as at December 31, 2013. The decrease YTD has been funded via cash flow from operations entirely and exclusively.

Unfortunately, we were unable to push our debt down to the USD 3bn we had promised previously, as the sale of gas assets to Rosneft has not been closed as yet.

I understand that this matter concerning Rosneft is very important, so, I would like to inform you that our framework agreement is valid through 30 April 2014. To meet Rosneft's requests, we updated our reserve estimates for the gas assets to demonstrate that our updated estimates are practically equal to the previous ones. Unfortunately, Rosneft was unhappy with the audit deliverables. So, following that, we have agreed with Rosneft to sign another contract on joint operations, on joint efforts, on those gas assets to become effective after the established framework agreement. According to this new agreement to be signed, we are going to drill another well at one of the gas assets to prove our updated estimates and to get back to negotiating on the deal further on. An approximate timeframe to drill that well is about 1 year. During the drilling time, we are going to invest some funding into development of those gas assets from the operating income of the gas assets themselves. Our purpose is to boost natural gas production and to double the financial results of the gas assets.

Now, let me conclude my presentation, thank you for your time once again and take your questions now.

Questions and Answers

Dmitriy Kolomytsyn – *Morgan Stanley*

I have three questions for you. The first question is regarding Rosneft. Do you have any other alternatives? Is there a strict contract that prohibits you from selling these assets to somebody else? Would it be possible for you to cancel the deal with Rosneft and put oil and gas assets for sale? The second question is regarding interest expenses in Q4 2013, we saw a sharp increase and we would like to understand whether this is going to be sustainable. And my third question is regarding Timir. When do you plan to receive the remaining portion of cash from EVRAZ and also what are your plans at this project? Thank you.

Ilya Ryashchin (translated)

As to your first question, I shall say that our established contract, framework agreement, with Rosneft is valid through April 30 this year, so, we are not going to consider any alternatives until it expires. However, further on, we may well consider some other attractive options, if any. However, I shall say Rosneft is a top priority for us, because we do see established links and interdependencies geography-wise and process-wise on those assets.

As for Timir, we are now talking with the EVRAZ Group on the second tranche for the equity stake they acquired. And we would like a possible extension of payment time to be dependent on a better understanding of investment opportunities, investment outlook of this project from both sides. I think we will get updated information on Timir in the coming weeks, maybe by end of April.

And the third question on interest payments will be taken by Anastasia.

Anastasia Misharina

Regarding interest expense, currently interest expense includes not only interest related to debt, but also interest related to pension obligations which has increased significantly following the amendments in IAS 19, and the related interest expense is currently included into finance cost. It is the main reason for the increased interest expense in the profit and loss statement. Thank you.

Dimitri Kolomytsyn

And do you expect this to be sustainable in 2014, so, should we adjust our interest expense going forward?

Anastasia Misharina

Yes, but you also have to remember that this is a non-cash expense.

Yulia Chekumaeva – *Goldman Sachs*

Good day everyone! Thank you very much for your presentation and my congratulations on the strong results reported for 2013. I have actually a couple of questions. First, what is the latest pricing dynamics on the rough diamonds market that you currently observe (if you can put it into perspective like relatively to the Q4 2013 dynamics)? And secondly, what is your current estimate for the production and sales volumes of rough diamonds by ALROSA in 2014, and do you plan the continuation of inventory destocking through 2014 as you did in 2013? And if it is planned, what is your current estimate on current terms? Thank you so much.

Ilya Ryashchin (translated)

As for the prices in Q1 vs Q4 there is a positive uptrend, it is 3–4% more that we see.

As for our production outlook, we expect 36 mln carats to be produced in 2014.

As for destocking, I shall reiterate our guidance to sell at least 2 mln carats annualy from stock on the horizon of the coming 2–3 years.

Pretty soon we will disclose our Q1 2014 operations update, and I hope you will get a pleasant surprise in terms of destocking.

Yuri Vlasov – *J.P. Morgan*

Thank you, a number of questions. First of all, could you, please, update us on transformation of Udachnaya from an open pit into an underground mine, how is it going? Is it going according to the plan? Second question is about Capex. With new changes, or new forecast for rouble exchange rate vs US dollar, do you have any changes in your Capex also? Seems like there is a new Capex coming for your oil and gas assets. Would you quantify, would you give any numbers that would lift your Capex, any actions you have to do before you complete the deal within the next 12 months? What would be the effect on your overall 2014 Capex? And the third question is your production plans for Severalmaz – are you still guiding 1.6–1.7 mln carats for this year? And the last question. Could you, please, without giving away trading numbers, give us your stock levels at the end of the year split into gem-quality and industrial? Many thanks.

Ilya Ryashchin (translated)

As for the Udachny mine, everything is on track, by mid 2014, we are going to launch the first stage of that mine.

As for our Capex in view of the evolution of ruble-to-dollar exchange rate and our gas asset developments, I shall say that we see no material impact there on our Capex. If there is any, we will anyway be able to find internal reserves, internal resources to offset that impact.

As for Capex for our gas assets, the core of it will fall on 2015 and our estimate is RUB 2bn per annum.

As for Severalmaz, we do confirm our production guidance.

As for stock volumes, at the end of 2013 it amounted to 17.7 mln carats.

Non-gem quality diamonds account for about 30% of stock, with the rest 70% of gem-quality.

Vadim Astapovich – *VTB Capital*

Hi, thank you very much for the presentation. I have a few questions. The first one is whether you could tell us if there is any targeted gem-quality / industrial quality diamonds breakdown for 2014. The second one is – I just want to make sure that the RUB 38.5bn Capex is still valid for 2014 and if you could split maintenance out of it. And the third question is on gas assets as well – if you have any plans to release production plans, stand-alone financials for those just to be able to evaluate the fair value of those assets. Thank you very much.

Ilya Ryashchin (translated)

As for our production breakdown into gem-quality and non-gem quality diamonds, I shall say that our production is stable in this respect. The balance is approximately 30% to 70%. 2014 is not going to be any exception to the rule.

As for our Capex plan, you have given the correct figure, and it is not going to change in 2014.

As for natural gas assets, please, do not hesitate to contact our Investor Relations to be updated on that. They will be happy to do so.

Vadim Astapovich

Yes, and could you just split out maintenance Capex for 2014 as well? That would be great. Thank you.

Ilya Ryashchin (translated)

This is a stable figure over years. It is about 40% of the total Capex. This year it will be about RUB 14–15bn.

Andrey Lobazov – *Bank of America*

Thanks a lot for this opportunity and congratulations on your strong results. Most of my questions have been answered already. I have one question on your product mix. As you disclosed in the presentation, a USD 10-per-carat y-o-y decline in average realised prices for gem-quality diamonds was attributable to changes in product mix. Can you please guide what is your product mix outlook for this year? Should we expect to see a negative impact this year? And my second question is on your working capital management. Do you have any working capital optimisation plans you can share with us, except for the inventory release, obviously? And my last question is on Ebelyakh River and Gusiny placers. If I understand correctly, a ramp-up at these assets is crucial to produce 36 mln carats this year. Can you please tell us about the operations at these assets? Does everything go in line with the expectations? Thank you.

Ilya Ryashchin (translated)

As for gem-quality / non-gem quality diamonds price movements, we expect no material changes in 2014.

As for working capital optimisation and management, I shall say that stock management and destocking is a top priority to us. This is the core tool to manage working capital.

However, another powerful tool is strict financial discipline, strict financial policies to collaborate with both our counterparties and customers. We are going to be active in optimising and managing effectively our accounts receivable. We hope these measures will pay off.

As for alluvial placers, I understand that your question is about the Nizhne-Lenskoye mining company we acquired last year. Last year, in 2013, our production was totally on track, we performed well against our production plan to produce about 1.5m carats.

We expect no material issues in the course of 2014 in this respect. In late Q2 2014, we will launch production on alluvial placers.

Des Kilalea – *RBC*

Thank you. Could I just confirm, the inventory that you hold, is that your inventory or does it include the inventory that is held by Gokhran? If it is separate, could you maybe comment on the Gokhran inventory and how it might be sold? Could you also comment on the outlook for dividends from ALROSA? And could you maybe comment on some of the news articles we have seen recently about the discovery of synthetics being found in parcels of natural diamonds? Thanks.

Ilya Ryashchin (translated)

As for your first question, our stock amount does not, certainly, include the Gokhran stock. So talking about inventory, we talk only about ALROSA's inventory. As for the second question on dividends, what we are going to propose to our Supervisory Board and our Annual Meeting of Shareholders is about 35% of net profit under IFRS.

As for those parcels, I cannot comment upon it in any way, because we do not know anything about this matter.

On the other hand, as a major diamond producer ALROSA must respond to all trends and developments in diamond markets, including synthetic diamond markets. We have already drafted a package of legislation proposals in order for those markets to be split into real and synthetic diamonds to make the overall environment more transparent and clear to the customer primarily.

Mariya Gancheva – *Mitsubishi*

Good afternoon. Just a quick follow-up, excuse me, if I missed it in the beginning, if you have answered this. I am just trying to understand, considering that the deal with Rosneft has taken a different momentum now, how are you planning to finance your short-term debt? And if it is new alternative loans, what is sort of the timeframe where you would be finalizing this? And my second question would be related to your ratings. Considering that they have given you some sort of timeframe in which you could complete the Rosneft deal, now that this is not happening, what do you expect to happen with your rating? Thank you.

Igor Kulichik (translated)

About the rating agencies first. In March, we had a big meeting with S&P in London. Following that meeting, S&P published quite an extended release on ALROSA. In a nutshell, our agreements with S&P: they do not change our rating, and they do not amend their outlook on our rating until end May.

During the same period of time, which is till end May, ALROSA will take certain steps to restructure its debt portfolio. We will also take this time in order to put more clarity into our relations with Rosneft concerning their deal with gas assets. The next meeting with S&P and other rating agencies is scheduled for end May. At those meetings we expect to show, hopefully, an improved loan portfolio structure, first, and second, certain updates on our Rosneft deal. So, we hope those changes will be perceived positively by the rating agencies.

As for short-term debt refinancing, I can say the following. Now we are active closing a number of deals with certain banks, let me not disclose their names so far. However, these important deals will hopefully enable us to dramatically restructure our debt portfolio in end April or early May to turn, effectively, 90% of our loan portfolio into a long-term nature. After those deals are closed, we will update you on their terms and conditions.

Mariya Gancheva

And just to follow up quickly, are there any plans for a Eurobond issuance?

Igor Kulichik (translated)

Not in the nearest future. So far, we are not considering any tapping into public capital markets.

Sergey Donskoy – *Societe Generale*

Thank you very much. I have some follow-ups. First of all, regarding your Capex in 2013. On page 13 of the presentation, you give the breakdown, and we see that you spent USD 6.4bn on non-mining operations, which was not gas assets and not social infrastructure. This amount increased about two times from the previous year. Could you, please, explain what these expenditures were? How do you expect them to develop this year? My second question: could you repeat your guidance for full Capex for 2014? I missed it. My third question: what approximate EBITDA was generated last year by the gas business? And question No. 4: your social costs outlook for 2014. In 2013, they amounted to RUB 4.6bn. Where do you expect them to be in 2014?

Ilya Ryashchin (translated)

As for your first question concerning our investment in non-core operations, that number was due to the acquisition of our office building in Moscow, on which we reported previously on the call. Further on, our Capex level will stay approximately flat versus previous years, so, that was a one-off effect.

As for the Capex plan for 2014, the total is expected at RUB 38.5bn.

In 2013, our gas assets generated an EBITDA of RUB 2.5bn.

As for social costs outlook for 2014, we expect a reduction of about RUB 1.5bn, which is effectively the expected amount of reimbursement we are going to receive from the Government of Yakutia.

Sergey Donskoy

Thank you. If I may, two very small questions in addition to that. First, when can we expect the duties for rough diamonds to be cancelled? What is the latest guidance? And second, Nizhne-Lenskoye consolidation, how much approximately did it add to your cost of production last year?

Ilya Ryashchin (translated)

Customs duties are subject to the decisions of the Russian Government. If I am not mistaken, those duties are going to be cancelled in 2016.

As for Nizhne-Lenskoye consolidated, its contribution into our revenue and cost is about 3%.

Dmitriy Kolomytsyn – *Morgan Stanley*

I have two follow-up questions. The first one is on your exploration Capex. Where do you see this amount in 2014 and going forward? Is it going to be in line with the guidance that we were giving during the IPO. And my second question is – what would be your depreciation and extraction tax in Q4 2013, if you exclude your gas assets?

Ilya Ryashchin (translated)

As for our exploration Capex, we do reiterate all our guidance given in the course of the IPO. The only developments and changes we could expect is some optimisation of those costs.

As for mineral extraction tax, you know it is hard to give you a breakdown by quarter, but for FY 2013 our gas assets accounted for RUB 550 mln of mineral extraction tax.

Dmitriy Kolomytsyn

And what was depreciation for the full year?

Ilya Ryashchin (translated)

About RUB 400 mln.

Dmitriy Kolomytsyn

And just a follow-up question from one of my colleagues. Would you be able to provide some sort of guidance for your Q1 2014 production numbers as well as the sales in Q1 2014?

Ilya Ryashchin (translated)

We will update you on that in a week. I hope you will be happy with the numbers.

Sergei Mezhokh

Thank you very much for the presentation. Have a good day**.**