ALROSA speakers

Ilya Ryashchin – First Vice President
Igor Kulichik – Chief Financial Officer
Sergei Mezhokh – Head of Investor Relations, Corporate Finance and Analytics

Participants asking questions

Neri Tollardo – Morgan Stanley
Sergey Donskoy – Société Générale
Yulia Chekunaeva – Goldman Sachs
Kay Hope – Bank of America Merrill Lynch
Dan Yakub – UBS
Oleg Petropavlovskiy – BCS
Ksenia Mishankina – UBS

Presentation

Sergei Mezhokh

Good day, everyone. Welcome to ALROSA conference call devoted to Q1 2014 results. I am Sergei Mezhokh, Head of IR. I will make a few introductory notes, as usual. We have on the call today Ilya Ryashchin, First Vice President, Igor Kulichik, CFO, and myself. We have prepared several slides for you, which are uploaded to the IR section of ALROSA’s website and were emailed to you earlier. We would refer to them while making the presentation.
Before we start, I would like to remind you that the information provided today may include forward-looking statements that involve risks, uncertainties, and assumptions. If such risks or uncertainties ever materialize or the assumptions prove incorrect, our results may differ materially from those expressed or implied by such forward-looking statements. We assume no obligation and do not intend to update any such forward-looking statements. Now I pass a word to Ilya Ryashchin. Please.

Ilya Ryashchin (translated)

Ladies and gentlemen, good afternoon. On behalf of ALROSA, I would like to welcome you to the Q1 2014 IFRS results conference call.
Revenue increase by 43% compared to Q1 2013, now amounting to more than RUB 56bn. The key driver behind this growth is represented by our sales volumes, which were increased in carat terms by 23% y-o-y.
We maintain a continued effort, as explained during the SPO, to sell down on our inventories, which were reduced in Q1 2014 from 18 to 13 mln carats. As a result, our EBITDA increased by 65% compared to Q1 2013 and reached a bit more than RUB 26bn; the EBITDA margin increased from 40% to 46%.
The net profit decreased slightly, by 3% y-o-y, as a result of the FX loss on our debt portfolio, which is denominated mostly in dollars.

Quite positively, our free cash flow increased by 2.5 times compared to Q1 2013, mostly as a result of increased cash flow from the rough diamond sales and cash flow from changes in the working capital. The extra cash flow was saved up to pay off the Company short-term debt as compared to the beginning of 2014, resulting in net debt reduction by 7%.

The higher diamond sales volume in carat terms and ruble depreciation caused an increase in diamond revenue in Q1 2014 compared to the same period of the previous year and to Q4 2013.

There is some good growth of the rough diamond market across 2014 YTD. Starting at the beginning of the year and until now we have observed a growth of 5–6%, and across Q1 that was 3%.

The average price decrease was driven in Q1 2014 by changes in the sales product mix.

We had an inventory selldown by 5 mln carats in Q1 this year, part of which was contributed by small size of less than half-a-carat which was resulted in a lower average realized price.

Also please mark the contribution of our gas assets into the revenue growth in Q1 2014. Gas sales added an extra RUB 1.1bn as compared to Q1 2013.

The 40% growth of the cost of sales is driven first and foremost through increased diamond sale volume – 23% growth y-o-y as well as other operations including gas assets.

Extraction tax costs increase was the highest line as compared to the previous year. There are several drivers behind this MET payment growth. That is increased volume of diamonds evaluated for MET calculation, weakening of the ruble and increased gas sales which are also subject to MET.

Transportation costs increased 3 times compared to Q1 2013 as a result of additional expenses of goods transportation by trucks in winter. That was due to reduced period of navigation on the Lena River in 2013, hence, we had to resort to overground transportation in winter time in 2013 and 2014 for particular important cargoes including fuel.

Other operating expenses went down by 14% y-o-y. This reduction comes as a result of reduced exploration and social costs.

I would like you to note some positive development of EBITDA: increase of 65% y-o-y and 46% q-o-q. Most importantly, EBITDA margin in Q1 2014 increased to 46%, which is record-high level for the company.

As for the net profit, regretfully due to increased exchange loss on our loan portfolio nominated in US dollars, our net profit was 3% lower than the year before, and the FX loss amounted to USD 8.9bn in Q1 2014.

The Company's expansion CAPEX grew by close to 30%. This is majorly driven through higher investment into maintenance and technical upgrade of our capacities as well as continued construction of Udachny underground mine. We are going to open its Stage 1 on 27 June.

This year marks reduced CAPEX into our Severalmaz asset in Arkhangelsk region. In March this year we launched Stage 2 of our beneficiation plant which increased our production capacities to 4 mln tonnes of ore per year. We have pretty much exhausted our investment into this project.

The cash flow from changes in the working capital increased 2.5 times; a very positive result as compared to Q1 2013. This was mainly driven by the inventory selldown.

Our debt went down from USD 4.1bn to 3.7bn, which was made possible thanks to our good performance in Q1 this year. Currently our loan portfolio is slightly in excess of USD 4bn which is the liquidity cushion we have built up in view of Eurobond repayment pending USD 500mln in November 2014.
If we keep observing the market trends as they are now, we would expect significant reduction of our debt portfolio by the end of the year.

Let us complete the presentation at this point. We are happy to take the questions now.

Questions and Answers

**Neri Tollardo – Morgan Stanley**

I have three questions. First, would you be able to give us some outlook guidance on Q2 in terms of what pricing you have seen, potentially some details on the diamond mix and perhaps profitability compared q-o-q? The second question relates to some data points that we have seen in the diamond market in India. The numbers seem to suggest that polished diamond exports have fallen 9% this year in the first five months while rough imports have increased 6%. Is that something we should worry about? Is that something that shows that the inventories that are being held in India have increased or that there is some mismatch in pricing between rough and polished diamond prices? And the third question is on gas assets. Again, if you could give us some details on the gas assets CAPEX and the mineral extraction tax for Q1 of this year and maybe the outlook for the rest of the year.

**Sergei Mezhokh**

If we speak about the current market situation and our assumptions for Q2 we can say that in Q1 this year we saw a price increase of around 3% and later on up to the current moment we saw a further increase of prices on the market. Currently we see diamond market stabilized on the levels achieved and our best hope is that the market will be where it is today till autumn of this year. We cannot give you a further guidance on Q2 average price per carat achieved because we have not finished our Q2 sales.

Proceeding to your question regarding statistics of India: you may have read press releases that there were some delays in certification of polished diamonds in India, which was actually explained by increased rough diamond imports to India which has led to an overload of the certification facilities in India.

**Ilya Ryashchin** (translated)

Let me comment on the gas assets and CAPEX split there. Yesterday, 26 June, we had Board of Directors meetings for both companies. Without getting too much into detail, I can sum up as follows: our focus now is to continue drilling mainly production wells to increase production, and secondly drill two exploration and test wells to reconfirm our reserves for Rosneft.

These are our focus areas for 2014 and 2015 that is where we are going to stream most of our CAPEX for the gas assets. MET calculation for gas is based on tariffs set by Federal tariff service of Russia.

**Sergey Donskoy – Société Générale**

I have two questions. Firstly, your destocking over Q1 was quite substantial, I think, you have sold down much more than planned – virtually for two years, 2014 and 2015. My question is: should we expect some restocking in the remainder of the year? What are your sales for the full year likely to be in respect to your production budget?

And my second question is: could you provide some guidance on your social costs and exploration expenses this year as compared to the last year? Thank you.
Ilya Ryashchin (translated)

Commenting on our inventories first, indeed, there has been a decrease in our stocks, and we are going to see a further reduction of the inventories for the 6M results. However by the end of year there will be a very slight restocking given we have seasonal operations in our alluvial deposits Almazy Anabara and Nizhne-Lenskoye.

These are seasonal operations with most production occurring in Q3. Hence, given the sorting, and premarketing, most of the sales occur in Q1. In a nutshell, we are not planning to restock as a deliberate action.

To comment on your other question, as explained during the SPO marketing, we have changed our relations with the Government of the Republic of Sakha (Yakutia) when it comes to social assets. We expect subsidies in the amount of RUB 1.7bn for different sorts of social costs. In March and April we already got part of the money as planned, from the Republic, which reduced our social burden.

Yulia Chekunaeva – Goldman Sachs

I have a couple of questions. If you could highlight what is the current status of Udachny underground mine development and what is the remaining CAPEX for this project and when do you expect the launch it and the ramp up schedule. And the second question is related to the current status of your negotiations with EVRAZ regarding TIMIR project. Where do you stand here and if EVRAZ has paid you the installments for the 51% stake acquisition in this project.

Ilya Ryashchin (translated)

Speaking of Udachny, which is translated from Russian as “Successful” mine, we are doing successfully there. As I mentioned, on 27 June we are launching Stage 1 in an inaugural event. The construction is going as planned and ramp up to full capacity is targeted in 2019. CAPEX-wise 2014 is the pick year and the following years will see a significantly reduced CAPEX.

Speaking of our TIMIR assets now, EVRAZ has approached us with a proposal to defer payment of the second instalment. This was considered by the Russian Government at the level of the First Vice-Prime Minister and the Government endorsed this subject to certain commitment on the part of EVRAZ as to commencing development of this project. This is only a slight deferral covering 6 upcoming moths.

Kay Hope – Bank of America Merrill Lynch

You pointed at deleveraging at the end of the Q1 but I do see debt back at 4.2 bn at the end of June, right as of today. When do you expect that figure to decrease on a more permanent basis and what was the liquidity that you mentioned ahead of the Eurobonds maturity?

Ilya Ryashchin (translated)

As we explained in the course of this presentation, the new hike in our debt is explained by building up this extra liquidity which we need to pay off the Eurobond in November this year. The difference between our debt numbers as you see at the end of March and as of today is exactly the liquidity we have in our deposits in view of the Eurobond repayment.

Kay Hope

And I were to ask you what the cash number is as of today? Would that reflect that?
Ilya Ryashchin (translated)

USD 600mln.

Dan Yakub – UBS

I really have just one clarifying question on prices and some clarifying questions on production. On prices: your average gem-quality price in Q1 was USD 155 per carat. That obviously included low-value inventory released but given that your overall sales were close to 12 mln carats… I understand that inventory could have been low-value, but what you produced in the Q1 must have also been of very low value. To bring this USD155 average per carat price there must have been either significant deterioration of the product mix or you were rushing to sell all that volume to secure the price. I’m just trying to understand: Is there going to be any recovery in that average price excluding new inventory in Q2 or should we just say: “Look, this is the new reality. ALROSA is only selling USD 155 per carat and your previous prices of USD 190 should no longer be expected.” This is the first question, and the second question relates to your biggest bread-and-butter mines such as Nyurbinskaya and Jubilee open-pit. I am trying to understand what is the current 2014 plan for rough-diamond production at Jubilee and Nyurbinskaya mines, those two biggest open pits that you have.

Sergei Mezhokh

About your question about our average price per carat shift in Q1 of this year, we have already stated today that there are two fundamental reasons for this. The major one is the change of the product mix. As you know, our product mix shifts from quarter to quarter, and the best way to understand whether there is a significant change in our product mix is to look at the longer period than just one quarter. For example, look at Q1: we sold 3 times less 10.8+ cts diamonds in Q1 2014. And another important reason for average price decrease is that due to favorable market conditions we were able to decrease our inventories with average price less than the average price of the company. Our strategy regarding trading this or that type of diamonds will of course much depend on the current market situation we will observe in Q2 of this year. And as for your question about our production plans for the specific diamond pipes, I think we'll revert to you directly later on.

Oleg Petrovlovskiy – BCS

Could you give us any guidance on your 2014 sales volumes? Earlier it was expected that your sales volumes would be 2 mln carats higher. What are your expectations for now? Second: what is your 2014 CAPEX guidance including gas assets and what was gas assets EBITDA for Q1 2014? And my last question is about this potential Far East diamond-cutting hub, which has been in the news for about a month? What could be your role in that hub? Could you please elaborate a little bit on this if you have any ideas?

Ilya Ryashchin (translated)

Speaking of our guidance on 2014 sales volumes, we indeed expect a certain increase here. We are finalizing the calculations now and I cannot provide a specific number but I assure you that the current guidance is higher than what we expected earlier. Our CAPEX guidance in 2014 is about RUB 38bn across all our assets. EBITDA for our gas assets in Q1 reached RUB 1bn. Speaking of the Far Eastern cutting hub development, frankly, cutting has been in place in the Far East already in certain slight volumes in Yakutia.

Ksenia Mishankina – UBS
Could you please indicate your leverage target and when do you plan to achieve it. And you said for your CAPEX guidance for 2014FY, it was RUB 30bn?

Ilya Ryashchin (translated)

Let me reiterate the CAPEX number. It is RUB 38bn across the year for the whole group for all their assets. The leverage target stands at 1.0x Debt/EBITDA. This is envisaged in our strategy and we target achieving it in the coming three to five years. It does depend on how soon we will have divested from the gas assets.

Colleagues, thank you for your attention and for your participation and for your questions.