



**ALROSA 9M 2014 IFRS Results
Conference Call Edited Transcript**

26 November 2014

ALROSA speakers

Ilya Ryashchin – *Acting CEO, First Vice President*

Igor Kulichik – *Vice President, CFO*

Sergei Mezhokh – *Head of Investor Relations, Corporate Finance and Analytics*

Participants asking questions

Neri Tollardo – *Morgan Stanley*

Andrey Lobazov – *Bank of America Merrill Lynch*

Des Kilalea – *RBC*

Mariya Gancheva – *HSBC*

Natasha Zagvozdina – *Verno Capital*

Presentation

Sergei Mezhokh

Good day. I am Sergei Mezhokh, Head of ALROSA's Investor Relations. I will make a few introductory notes. Our call today is led by Ilya Ryashchin, acting CEO and First Vice President, and Igor Kulichik, CFO. We have prepared several slides for you, which are at the IR section of ALROSA's website and were sent out this morning. We would refer to them while making the presentation. Before we start, I would like to remind you that some information provided during this call may include forward-looking statements that involve risks, uncertainties, and assumptions. If these risks ever materialise, 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*)

Good evening, ladies and gentlemen. On behalf of the Company, I would like to welcome you at today's call presenting ALROSA's results for 9M 2014.

The Company's results in the reporting period were largely influenced by the continuing weakening of the ruble to the US dollar, which, on the one hand, had a positive impact on the Company's cash flow, but on the other hand, had a pressure on the financial results due to revaluation of the US dollar-denominated debt.

The Group's revenue for 9M 2014 was up by 21% y-o-y to RUB 146.9 bn, EBITDA was up by 28% y-o-y, margin was 45%, net cash flow was RUB 22.6 bn (up 5.6 times y-o-y).

Revenue from the sale of gem-quality diamonds in the reporting period was RUB 120.7 bn representing a 20% growth. The main drivers of the revenue growth were a weaker exchange rate of ruble against US dollar and increased sales of gem-quality diamonds in carats due to reduction in inventories.

Talking about the market, we see some positive trend there. The price growth for ALROSA's rough diamonds on comparable terms was 8%, which was above our internal forecast.

The main drivers of demand above our expectations was continued improvement of economic environment in the US –the leading consumer of diamond jewelry, which resulted in sales growth of the world' largest jewelry retailers.

Currently, we see supply and demand balanced in the diamond market, and we expect the demand to grow early next year as a result of the Christmas holiday season and jewelry sales in that period. In the short term, we see the price to increase by approximately 3% a year.

In 9M 2014, ALROSA sold almost 29 mln carats of diamonds, which is 3 mln carats higher than the production in the same period. As you remember, in H1 2014 sales volumes were above production volumes by approximately 5 mln carats. By the end of Q3 2014, our diamond inventories were up by approximately 2 mln carats due to the seasonal increase in production at our alluvial production subsidiaries.

As at the end of Q3 2014, our diamond inventories were approximately 14.5 mln carats, the structure of which is similar to the range of our production.

As for our sales in Q3 2014, they are lower than in Q2 by 12% largely due to the reduction of sales in carats corresponding to the low summer holiday season.

I would like to draw your attention that in Q3 2014, we had a different production mix compared to Q2. The reason for that was the seasonal increase in diamond production from alluvial deposits of our production subsidiaries, the average price for which is lower than across ALROSA , as a whole.

Talking about cost of sales, the 21% growth is explained first of all by higher volumes of diamond sales in carats by 6%, higher gas sales, depreciation and mineral extraction tax.

The depreciation growth for 9M 2014 is explained by depreciation accrued for production licenses, higher gas production, commissioning of new equipment at Severalmaz and Udachny and Aikhal divisions.

The higher MET is explained, firstly, by weakening of ruble to the US dollar, and secondly, by the new price list of the Ministry of Finance, which is used for MET calculation, from 15 March 2014. As a result, the price increased by 35% this years.

In 9M 2014, the Company obtained almost RUB 1 bn of compensation for maintaining the loss-making social infrastructure in the Republic of Yakutia. We expect that in 2015 these compensations will amount to over RUB 2 bn.

Continuing to talk about the cost of sales, materials costs were down by 12% compared to 9M 2013, and services increased by RUB 1.3 bn, as a result of increased volumes of works of third party contractors and lower maintenance works carried out in-house.

Moving on to EBITDA and net profit, I would like to mention the positive impact of a weaker ruble on ALROSA's results, EBITDA grew by 28% compared to the same period last year. Unfortunately, revaluation of part of the debt portfolio denominated in US dollars led to reduction of net profit by 44%.

In the reporting period, CAPEX was 6% lower than the same period last year, at RUB 22.3 bn. The reason for CAPEX reduction was commissioning of the second module of the processing plant at Severalmaz.

Talking about working capital and cash flow, I would like to note some positive results there. Higher cash from diamond sales and lower investments in working capital were the main drivers of higher cash flow which increased 5.6x compared 9M 2013.

Following the repayment of eurobonds in the amount of USD 500 m, our debt stood at USD 3.7 bn. Currently, the Company is finalizing determining the sources of liquidity for meeting its 2015 debt repayments.

In conclusion, I would like to say that the Company fully understands that a weaker ruble influences the net income and thus the basis for dividend calculation.

When 2014 actuals are available, the management will formulate its proposals on the possible size of a dividends taking into account factors that affected net profit.

With this I would like to conclude my presentation and open a Q&A session. We will be happy to take your questions. Thank you!

Questions and Answers

Neri Tollardo – *Morgan Stanley*

Gentlemen, thank you for the conference call. A few questions from my side. First on CAPEX. Could you maybe elaborate a little bit on why CAPEX was so low in the first 9M 2014? It is annualizing at about RUB 30 bn, which is significantly below your budget. Is this lower CAPEX due to optimization or has it been postponed to future years? And then a question on capital structure. Will the cash that you will not be using for dividends be used to repay your debt? And would you prefer to repay your US dollar or ruble debt? Effectively, do you aim to maintain the current split between US dollar and ruble debt? And the last question on the CEO appointment, if there is any news on that front.

Ilya Ryashchin (translated)

Talking about our CAPEX, we intend to meet our CAPEX plan. I think it is not entirely fair to annualize the previous quarter results because most of the commissioning will occur in Q4 2014.

Talking about debt repayment, we do not look for maintaining any target currency split, but rather we look at our debt repayment schedule and intend to meet our obligations as they mature. Our next year maturities are roughly 40/60 in rubles and US dollars and amount overall to approximately USD 1 bn, which is what we intend to pay out in 2015.

As for the appointment of the CEO, I currently have no information as for the timing the new CEO might be appointed.

Neri Tollardo – *Morgan Stanley*

Could I ask a follow-up question? Do you plan to reach the RUB 38 bn target for CAPEX that you were guiding for at the beginning of the year, or could we expect something a bit lower than that? Thank you.

Ilya Ryashchin (translated)

If it happens to be lower, then not significantly lower than what we initially gave as guidance – probably, by RUB 1–2 bn, not lower than that.

Andrey Lobazov – *Bank of America Merrill Lynch*

I have two questions, if I may. My first question is a follow-up on CAPEX. Can you, please, reiterate your CAPEX guidance for 2015 and remind us which portion of it is effectively in US dollars? My second question is on your treasury shares. If I see it correctly, the number of treasury shares held by the Company declined from 6 mln as at the end of Q2 2014 to less than 2 mln as at the end of Q3 2014. Can you, please, elaborate a little bit on what is ALROSA's strategy here? Should we expect more or less treasury shares going forward? Thanks.

Ilya Ryashchin (translated)

Talking about CAPEX guidance for 2015, it is unchanged at approximately RUB 36 bn. As for the dollar share of that CAPEX, it is insignificant at some 10% of our purchases of materials.

Igor Kulichik (translated)

On the treasury stock: it was not the parent company, but some of the subsidiaries that held some of the Company's shares, and they sold it in the course of the year. Then, at the end of Q3 2014, the remaining treasury stock was held by the insurance company, but since then the insurance company has been sold, so, it has zero treasury stock on its balance sheet.

Des Kilalea – RBC

A couple of questions. First is could I ask you to reiterate what you said on the dividend? Are you saying that your policy of 30% will no longer be the case because the conversion effect of a low ruble is making the bottom line much less and therefore you move to a cash flow type multiple. I am not quite sure what it means, does it mean higher or lower dividends. And then, the next thing is on prices. You mentioned that in the short term you see prices increasing by 3%. Is that your forecast for 2015 or is that the last quarter of the year? Referring to slide 6, you show that in 9M to September 2013 price was USD 171, going up to USD 175, of which USD 1 was price, and the rest was mix. Could you kind of comment on that and say what your average price rise run-of-mine to date might be, say, for the first 9M 2014?

Ilya Ryashchin (translated)

On the dividend policy, we do not intend to review our approach of determining the minimum level of dividend at 35% of our IFRS results. But this does not mean that the dividend will amount to exactly this number. We intend to wait for the full year actual and look at where the exchange rate is. And then to offer the dividend amount which would incorporate the effect of the changes in the exchange rate.

Talking about your second question about the price, we do not plan any price increase for Q4 2014. The quarter is almost over and there has not been any price increase. The 3% growth that I have mentioned is of course for the future periods, mainly for 2015. Our average price in 9M is as mentioned on the slide at USD 175 per carat of gem-quality diamonds.

Mariya Gancheva – HSBC

Two very brief questions on my side in terms of your liquidity profile and funding policy for 2015. You have roughly 30% of your debt being short term, with a mix of ruble and US dollar-denominated maturities, as you have mentioned. What is the plan of funding this, how will you be refinancing this – will you be looking into loan market or will you be looking into the bond market?

Ilya Ryashchin (translated)

As I have already mentioned, in the next few days we will finalize our 2015 refinancing programme, so we would have all the liquidity in place. That is true of both the US dollar and ruble-denominated components.

Natasha Zagvozdina – Verno Capital

I have two questions. One is regarding the margin outlook for the last quarter of this year. With diamond prices as you have indicated flat vs Q3 2014 and the ruble being weaker, a lot will depend on the mix in terms of diamond quality. My question is as follows: shall we expect Q4 2014 to be the strongest in this year in terms of EBITDA profitability? It was the highest in Q1 2014 with 46.4%. That is my first question.

Ilya Ryashchin (translated)

We believe that Q1 2014 was the strongest in terms of the margin. We will see Q4 2014 at the lowest margin because of higher costs in Q4 2014 and higher sales of industrial diamonds.

Natasha Zagvozdina – *Verno Capital*

Thank you, and my second question was about CAPEX in or after 2017 when you finish your big investment projects. Right now, you will be spending, as I understand, RUB 36 bn a year in 2015, 2016 and 2017, or will 2017 be the first year with a lower CAPEX?

Ilya Ryashchin (translated)

We see our CAPEX declining each year over the five-year period. The minimum CAPEX will be in 2018 at RUB 22 bn. Once we have completed our major investment projects, we see our annual CAPEX level at RUB 24–25 bn.

Neri Tollardo – *Morgan Stanley*

Just another question. Could you, please, repeat how much inventory you plan to sell for the whole of 2014? And related to that: has Gokhran participated in any of your sales this year or has it expressed any demand for your diamonds in 2014? Thank you.

Ilya Ryashchin (translated)

We expect inventory selling in the course of the year to be 3–4 mln carats. And as for Gokhran, we do not plan any sales to it either this year or next year.

Dear colleagues, thank you very much for your attention to the Company and for your questions. We will try to continue doing everything possible to please you with our results. Thank you!