



**ALROSA FY2014 IFRS Results
Conference Call Edited Transcript**

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ALROSA speakers

Ilya Ryashchin – *Acting CEO, First Vice President*

Igor Kulichik – *CFO, Vice President*

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

Participants asking questions

Nikolay Sosnovskiy – *UBS*

Neri Tollardo – *Morgan Stanley*

Des Kilalea – *RBC*

Sergey Donskoy – *Société Générale*

Russell Fryer – *Baobab Asset Management*

Anna Antonova – *Sberbank CIB*

Boris Sinitsyn – *VTB Capital*

Alexander Rozhetskin – *UniCredit*

Denis Gabrielik – *Otkritie Capital*

Presentation

Sergei Mezhokh

Good day, and welcome to ALROSA's conference call on 2014 results. I am Sergei Mezhokh, Head of IR. I will make a few introductory notes. Today, our top management is led by Ilya Ryashchin, acting CEO and First Vice President, and Igor Kulichik, CFO. We have prepared several slides for you, which are uploaded to the IR section of ALROSA's website and were e-mailed to you earlier. We would refer to them while making the presentation.

Traditionally, before we start, I would like to remind you that some information provided during this call may include forward-looking statements that may involve risks, uncertainties, and assumptions. If the 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 the word to Ilya Ryashchin. Please.

Ilya Ryashchin (*translated*)

Ladies and gentlemen, good day. On behalf of ALROSA, I would like to welcome you to this call to announce our financial results for 2014. I would like to mark here that the past year was very successful for the

Company, performing up to the plan across the board, and first in our history selling more than USD 5 bn of diamonds.

Before providing any further comment on our financial performance, I would like to mark the very significant impact that our numbers felt from the devaluation that was huge in 2H 2014.

Our revenue for 2014 went up by 23% to reach RUB 207.2 bn, whereas the EBITDA went up by 36% and reached RUB 93.9 bn; the margin was at 45%, whereas the net cash flow stood at RUB 44.8 bn, which demonstrates the growth of 2.6-fold vis-à-vis the last year.

Our revenue growth in 2014 by 23% was driven mainly by the increase in revenue from diamond sales by RUB 34.8 bn. The revenue was further boosted by our gas sales: the increase in revenue from sales of gas in 2014 reached RUB 6.8 bn, a 20% growth y-o-y. Other revenue also went up, mainly thanks to subsidies we received from the Republic of Sakha (Yakutia) in 2014 in the amount of close to RUB 1.7 bn.

Proceeding to the sales overview of ALROSA and the diamond market, let me say a few words about the development of that diamond market last year and as of now.

The situation in 2014 was developing diversely. The market prices for diamonds in 1H 2014 went up by about 11%, whereas in 2H 2014 they went down by a comparable amount. ALROSA pricing in 1H 2014 went up by 8% and remained flat until the year-end.

The market growth in 1H 2014 was driven mainly by the economic recovery in the US, which explains high production of polished diamonds.

In 2H 2014, the market saw excessive supply of polished diamonds, which was explained by the expectations of speedier recovery in the market and liquidity shortages with cutters and polishers, which resulted in negative pressure on the pricing. In February 2015, ALROSA adjusted its prices downwards by about 3%.

As of now, the diamond market demonstrates certain stabilization of the situation. We look into 2015 with moderate optimism, expecting an average price growth for the full year at about 3% based on positive macro forecasts for good development in key markets for jewelry, which employs polished diamonds, and also lack of significant sources of additional supply of rough diamonds.

ALROSA's revenue from gem-quality diamond sales in 2014 reached RUB 169.9 bn, which is an increase of RUB 29.4 bn, or 21%, vis-à-vis 2013. We observe a significant impact on this revenue from the stockpile sales, as well as the ruble devaluation vis-à-vis the US dollar.

In 2014, ALROSA reduced its stockpile by 3.5 mln carats from 17.7 mln to 14.2 mln carats, thus selling a total of 39.6 mln carats across the year, whereas it produced 36.2 mln carats, thereby exceeding our plans previously announced to sell extra 2 mln carats on the stockpile.

Across 2014, our average realized price for gem-quality diamonds reached USD 171 per carat, which is 3% lower y-o-y. The reduction in average realized price, regardless of the pricing environment, is explained by a different sales mix as we increased the sales from our alluvial places of Almazy Anabara and Nizhne-Lenskoye, where the average price is less than the Group average.

In Q4 2014, as compared to Q3, the situation was pretty much similar: our revenue was boosted through the ruble devaluation and stockpile sales.

The 20% increase of cost of sales was driven mainly through higher volumes in physical terms, expense for depreciation, mineral extraction tax, as well as fuel and energy, and also the increase in sales of gas.

The depreciation charges went up due to higher gas sales volumes, as well as launch of new equipment and facilities at our gas assets.

The increase in MET payments by 40% was driven equally by two factors: the ruble devaluation and the change in the Ministry of Finance's pricelist which is used for MET calculation from 15 March 2014. The pricelist prices went up by 35%, but let me remind you that this is offset by compensations we receive from the Republic of Sakha (Yakutia), which in 2014 paid the total amount of RUB 1.7 bn.

The fuel and energy expenses went up by 24% in 2014 driven by higher tariffs and production volumes at our affiliates.

Increase in wages, salaries and other staff costs in 2014 by 5% resulted from indexation at the inflation rate. As I have already explained, one of the key drivers of EBITDA growth is the ruble devaluation vis-à-vis the US dollar, boosting our EBITDA by 36% y-o-y, whereas the margin went up to 45%.

The rouble devaluation vis-à-vis the US dollar, which boosted our revenue in 2014, also accounts for the accounting-only, or paper-based, loss for the Group in 2014. It is explained by the negative FX loss following the devaluation of our debt portfolio, which is 90% USD-nominated.

Before the question on dividend payout for 2014, let me explain that the Company's management is discussing with its major shareholders that dividends are to be paid, and the optimal variant, as we call it, is in line with the previous year, regardless of the accounting-only loss that the Company has.

For the year 2014, capex went down by 13% vis-à-vis 2013 to reach RUB 33.3 bn. The reduction is explained by finalized construction and commissioning of the second module of the processing plant at Severalmaz, and also the relatively high base for the previous year.

Another reason why our capex in 2014 was lower than initially announced is the fact that we postponed part of that to carry it over to 2015.

The Company increased its investment in the working capital by about RUB 1 bn through higher expense for production materials and construction, as well as higher tax payments. The positive development of our cash flow is driven by decrease in trade and other receivables obtained from our customers as they are compensating for the VAT deferral (end of 2013) for the domestic sales.

The growth in net cash flow was 2.6-fold to reach RUB 44.8 bn, explained by the growth of our operating profits, as well as reduced capital expenditure.

The current amount of our loans and borrowings stands at USD 3.5 bn following the extension dated December 2014 for the total amount of USD 600 mln to 2018. 90% of our debt is long-term.

Looking forward into 2015, June and October this year mark the several bond repayment for the total amount of RUB 20.0 bn, whereas the Company has close to RUB 43 bn of deposits. Thus the Company has enough liquidity to pay out the debt as planned in 2015.

Moreover, given the current FX rates (the ruble vis-à-vis the US dollar), our operating cash flow would suffice for early repayment of debt for USD 1 bn in 2015.

These have been the highlights of our performance in 2014, and we are ready to take your questions. Thank you.

Questions and Answers

Nikolay Sosnovskiy – UBS

I have got a couple of questions. First of all, on prices. You have mentioned that in February ALROSA's average realized price was down 3%, but as Bloomberg newswire reports, De Beers price was down 4% in January and another 2–3% in February. How did you manage to hold prices nicer than De Beers? And second question is on prices also. Do you expect any improvements in product mix this year that can bring average realized prices up compared to 2014, if we take all other things equal, e.g. no increases in the underlying benchmark prices..

Ilya Ryashchin (translated)

Referring to the De Beers reductions that you have mentioned. These are effectively calculated average not necessarily reflecting the change in the pricing policy, but rather changes in the mix as it may. We can assure you that we are monitoring the market situation very closely and our pricing policy is in line with the market. Considering the influence of product mix on average realized prices, the latter could be affected by changing the former, but we are not resorting to this tool, since we produce a stable mix across our production facilities and we need to sell the whole volume that we produce.

Nikolay Sosnovskiy – UBS

One follow-up on prices: in Q1 and Q2 you also allowed your long-term clients to defer some 20–30% of volumes to March and beyond that. Do you see them coming and buying these delayed volumes in March and do you expect them to do so in April?

Ilya Ryashchin (translated)

Just to clarify, our proposal to the long-term clients was to defer procurement of 30% in the month of January only, for the other months it is 10%. Regarding your second question, yes, we expect this deferred demand to be realized in the later months.

Neri Tollardo – Morgan Stanley

First of all, just two clarifications. Am I correct in understanding that management is keen to maintain the dividend at least at the 2013 levels – RUB 1.47 per share? And does it plan to repay early USD 1 bn of debt? Another question is on capex. As far as I understand, there were some delays in capex that will be caught up in 2015. What kind of capex changes or updates can we expect from the IPO capex schedule given the ruble depreciation, and how much higher can capex be in the next few years? And the last one on your cash cost expectations. What kind of inflation do you see from mining cash costs given the spike in the ruble depreciation that we saw late last year?

Ilya Ryashchin (translated)

Considering your first question on the dividends, yes, your understanding is correct, the management is going to propose to the Board that the dividend payout in rubles is kept flat as compared to 2013 levels. Speaking of the USD 1 bn debt repayment, yes, that is our plan for this year. As for our capex plan, around 15-20% of that is FX-related.

The Company is undertaking dedicated efforts to replace imported facilities with domestically produced. I would not produce any particular number here, but I can assure you that there is no significant change of our capex plan as compared to initially announced.

As for the mining cash cost, the situation is even more straightforward. The mining cash cost has much no exposure to foreign currencies, except for some spare parts, which are definitely not the largest line. And the cash cost will be mostly driven by the domestic inflation this year.

Des Kilalea – RBC

The first question - I just wanted to be clear that last year average prices, excluding mix, were at 4%, down 3% in the first couple of months and you expect plus 3% for the full year. That's just a clarification. Could I also ask on the MET, there has been no change to the state price since the one early last year, is that correct? And finally, could you give us a projection of carat sales, production carat sales? How much do you expect to destock and have you been using Gokhran to buy any stones to boost your sales?

Ilya Ryashchin (translated)

Considering the pricing environment in the market, obviously we did not expect to reduce the prices early in the year. We believe 2015 will be a good year if the price recovers back to where it was and goes up another 3% by the end of the year.

Speaking of the Ministry of Finance pricelist, which is used for the mineral extraction tax calculation, it normally changes rather frequently, but we do not expect a major move as there was in 2014.

And referring to your third question, our plan for 2015 is to destock by 2 mln carats.

Speaking of any sales to Gokhran, there are no such plans for 2015.

Sergey Donskoy – Société Générale

Two follow-ups. If you could please provide just one number for what your current capex budget stands for the current year. And also one question on destocking. Just to clarify, you have increased your production in carats over the last several years both by organic growth and by growing inorganically. At the same time, you have been destocking over 2013, 2014 and, as I understand, you plan to continue destocking this year. This reduction in your stockpiles is quite significant if measured in months of production. Does it reflect a change in your marketing policy or something else? Why after all have you decided to change the volume of stones that you hold in stockpiles? Thank you.

Ilya Ryashchin (translated)

Referring to your first question, the total capex number for 2015 stands at RUB 36 bn. Considering the destocking question, no, that's not a new marketing policy, as you may have suggested, we are just leveraging on the opportunities we see currently in the market, and we try to destock and we will continue to destock as we can through streamlining and improving our operations, first and foremost, that concerns the sorting facilities.

Sergey Donskoy – Société Générale

And if I may ask one more thing. Is there any target level for the stockpiles that you have in mind either in absolute terms or in terms of months of production?

Ilya Ryashchin (translated)

We believe that the number we are targeting is 2.5 to 3 months of production or 10 to 11 mln carats.

Russell Fryer – Baobab Asset Management

What is the sustaining capex for 2015 and 2016? You mentioned 2015 earlier. And what will be the corresponding mine production only, not inventory sales, but mine production in 2015 and 2016? And then I guess my follow-on question is understanding your mix of rough diamonds — what percentage of your sales have been below 1 carat and what percentage above 4 carats?

Ilya Ryashchin (translated)

Considering our capex for 2016 onwards, that will be going down. And I can give you some flavor to that – 30 bn for 2016, 25 bn for 2017 and 22 bn for 2018.

Considering our production volumes, pure production: that will be growing up slightly as compared to the current levels, that is 38 mln carats currently, to reach 40 mln carats in 2019.

Referring to your follow-up question as to the mix and the sizes, this is not how we normally break that down. If you could send your question in, we will be happy to follow-up in writing.

Anna Antonova – Sberbank CIB

A quick question from our side. You referred that your mining as well as other opex costs should be mainly driven by domestic inflation. Could you please share with us what your expectations of the general opex inflation for this year are. Thank you.

Ilya Ryashchin (translated)

You are asking a question that can hardly be answered by anyone, I believe, but if we stay within a 12 to 15% threshold, that will be very good for the Company.

Anna Antonova – Sberbank CIB

Thank you. And what is your budgeted cost increase, what do you expect when you review your budget plans for this year? What is your base case scenario for the inflation?

Ilya Ryashchin (translated)

We did the budgeting exercise back in September last year before the volatility of the markets observed end of year, and at the time the inflation expectation stood at 5 to 6%. But, mind you, the revenues were also budgeted at the FX rate of RUB 45 per USD.

Boris Sinitsyn – VTB Capital

I have got one question on your Catoca mining investment. What is the current status of your investment? Do you plan to obtain a share in production of this company, for example, in 2015 or 2016?

Ilya Ryashchin (translated)

The Catoca situation remains unchanged, we are not expecting to ramp up our investment there and it is too early to discuss any share in production at this point.

Alexander Rozhetskin – *UniCredit*

One question from my side. You were planning to sell your gas producing assets earlier. Could you please update us on whether you are still planning to do the sale or whether you are happy with the production as it is.

Ilya Ryashchin (translated)

We are definitely happy with the production and overall performance of our gas producing assets, but at the same time they remain as planned for sale. Following the results of the exploration drilling we are currently undertaking. We will revert back to discussions with Rosneft or any other potential buyer as announced previously.

Alexander Rozhetskin – *UniCredit*

Thank you and a follow-up. Could you maybe give some timeframe for the completion of drilling?

Ilya Ryashchin (translated)

The drilling will be finalized in April.

Denis Gabrielik – *Otkritie Capital*

I have one quick question regarding your gas assets. What was the average price of gas and condensate in 2014 and what price levels are we to expect in 2015?

Ilya Ryashchin (translated)

Our average selling price of gas in 2014 was around RUB 1,800 per thousand cubic meter and we expect the same level in 2015. Average selling price of condensate in 2014 was RUB 15,260 per ton, while for 2015 we expect the level of around RUB 16,000 per ton.

Ladies and gentlemen, we would like to thank you for being with us on this call. The Company and its management team tried very hard to ensure good performance across the past year and I hope the results we are delivering today are more than satisfactory for you as well and we will be happy to see you at our next call. Thank you.