



**ALROSA**

ALROSA Q1 2015 IFRS results  
conference call edited transcript

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## ALROSA speakers

**Igor Kulichik** – CFO, Vice - president

**Sergei Mezhokh** – Head of investor relations, Corporate finance and analytics

## Participants asking questions

**Neri Tollardo** – Morgan Stanley

**Des Kilalea** – RBC

**Roman Gorokhov** – J.P. Morgan

**Boris Sinitsyn** – VTB Capital

**Oleg Petropavlovskiy** – BCS

## Presentation

### **Sergei Mezhokh**

Good day, and welcome to ALROSA's conference call on Q1 2015 results. Our top management team today is led by Igor Kulichik, our CFO. We have prepared several slides for you, which are in the IR section of ALROSA's website and were e-mailed to you earlier. We will refer to them while making this presentation. Before we start, as usual, I would like to remind you that the information provided during this call may include forward-looking statements that may involve risks, uncertainties, and assumptions. If the risks or uncertainties ever materialise, or the assumptions prove to be incorrect, our results may differ materially from those expressed or implied by such statements. We assume no obligation and do not intend to update these forward-looking statements.

Now I pass the word to Igor Kulichik. Please.

### **Igor Kulichik** (*translated*)

Dear colleagues, I am very happy to welcome you to ALROSA Q1 2015 results presentation conference call.

The Company's performance in Q1 2015 is driven to a great degree by a favourable situation on the FX market. Thanks to the ruble devaluation vis-à-vis the US dollar, our sales and margins have been record-high.

The diamond market in Q1 2015 was less active than in Q1 last year, and less than we had expected originally, which resulted in the Company reducing the prices by 6% year to date.

According to our assessments, the driver behind the reduced activity in the diamond market is effectively lower demand from Indian cutters and polishers, whose sales currently are mostly carried out through reducing the stock. The macroeconomic environment effecting demand for jewelry products with diamonds is still positive.

The Group's revenue in Q1 2015 went up by 31% to reach RUB 75 bn, whereas the EBITDA went up by 65% to hit RUB 43 bn. The EBITDA margin reached 57%.

The free cash flow reached RUB 32 bn, which is 58% higher than the year before. The cash and cash equivalents at the end of Q1 2015 went up 2.5 times to reach RUB 54 bn.

The revenue growth for ALROSA in Q1 2015 by 31% y-o-y is explained and driven, first and foremost, through a higher revenue from diamond sales, which grew by RUB 18 bn, of which RUB 17 bn come from gem-quality rough diamonds.

Gem-quality rough diamond revenue increased y-o-y due to the increase in the average price of gem-quality diamonds as well as ruble depreciation.

In Q1 2015 revenue from the gem-quality rough diamond sales increased vis-à-vis Q4 2014, which is explained, first and foremost, by the ruble depreciation vis-à-vis the US dollar.

The average price of gem-quality rough diamonds sold in Q1 2015 remains pretty much flat vis-à-vis Q4 2014 due to the redistribution of our mix through lower sales from alluvial deposits.

The increase in cost of production is explained, first and foremost, by higher wages, salaries and staff costs, as well as depreciation, extraction tax and fuel and energy.

The increase in wages, salaries and staff costs is explained by adjustments by inflation and a new approach to provisioning for further payments to employees and managers of the Company.

The increase in depreciation payments is driven mostly by higher production volumes in carat terms, also coming through commissioning of Severalmaz facilities, the Udachny underground mine, and the start of production at the Botuobinskaya pipe.

The increase in mineral extraction tax payments is attributed to the fact that as of 15 March 2014 the Ministry of Finance introduced a new price list for the purposes of extraction tax calculation, thus resulting in a 35% increase in the accounting prices, and also another driver was the ruble depreciation vis-à-vis the US dollar.

Fuel and energy costs increased due to higher fuel prices and demand for fuel and energy due to lower average air temperature in the Republic of Sakha (Yakutia).

Net profit and EBITDA have been record high due to the ruble depreciation vis-à-vis the US dollar.

In Q1 2015, our capital expenditure decreased by 15% vis-à-vis Q1 2014, to RUB 7 bn. The driver behind this decrease is reduced investments into Severalmaz facilities as well as the Aikhal underground mine.

The Company increased its investments into the working capital by about RUB 7 bn, mostly through increased inventories of ore and concentrates in line with our production plan.

Free cash flow has grown by 58% to reach nearly RUB 32 bn, mostly driven by higher operating profits as well as reduced capex.

As at the end of Q1 2015, the debt stands at about USD 3.5 bn. In the course of Q1 2015, ALROSA established a source of liquidity in view of the 2015 bond repayments for the total amount of RUB 20 bn, and also in view of dividend payouts for 2014.

This concludes my presentation, and we are ready for your questions. We are starting the Q&A session now.

## Questions and Answers

**Neri Tollardo** – *Morgan Stanley*

First, on your pricing of diamonds. I see you have said you have lowered the prices by 6% year to date. I was wondering if you could give us some colour on how customers have reacted to the latest price decline, whether they were happy with the current level of rough diamond prices, whether they were asking for more, and sort of your view on what you plan to do with diamond prices going forward, towards the end of the year.

My second question is on the wage inflation. Are Q1 wage costs a one-off that is going to be too high compared to what we are going to see going forward, or is this a new level of wages that we will see every quarter?

And the last question. A few weeks ago, there was news about the Board considering a plan to lower operating expenses by about 2–3% a year. Could you give us a little bit of colour on that, if that is true, and what the plan is with regard to that?

**Igor Kulichik** (*translated*)

Responding to your first question on the 6% price decrease. To start with, we are in close contact with all our key offtakers and clients. For your information, that 6% reduction was not a one-off step, it was gradual, and it came as a result of numerous consultations with our clients that took place in the course of Q1.

Considering your follow-up question on our vision on the prices by the end of the year. According to our feelings and expectations shared by our clients, the fluctuation affecting the pricing environment in the market in Q1 and Q2 are over now, so we do not expect any major step down.

As I explained during the presentation, India has affected the pricing environment to a great degree with their local issues. However, by now the market has found a new balance point.

Now let me comment on the reduction of our operating expenses. Cost-cutting exercise is a regular activity that we undertake on an everyday basis. We do that monthly, we do that yearly, and we do not focus that much on the benchmark of 2 or 3% per year. This is our continuous effort. For certain cost items, we have seen a several-fold decrease in the course of past few years. On top of that, other items contributed only 1 or 2%, but overall, across the board we are involved in this exercise.

You also asked about wage inflation. The indexation or readjustments that we undertook is a one-off event per year. It only takes place one time a year according to our collective bargaining agreement. It provides that we have to adjust our wages and salaries by the inflation rate as reported by the Russian official statistical agency. In Q1, we also introduced provisions for bonuses to be paid to the management team of ALROSA according to the new KPI plan as adopted last year. That explains a major gap between the Q1 2015 and Q1 2014 payroll. If you consider Q2, Q3 and Q4 this year, you will not see that much of a difference.

**Des Kilalea** – *RBC*

Two questions. I wonder if you could put more detail on to the staff increase and this methodology of accrual and personnel and management reserve. And then, maybe, just an indication of what your inventory looks like in terms of type of goods, if you have been holding back certain stones because, maybe, slightly bigger commercial goods and rather selling some cheaper goods, some indication on that in the average value of the inventory. Thanks.

**Igor Kulichik** (*translated*)

Let me give you a more granular view on the staff cost increase. There were two major drivers. We adjusted the wages and salaries in the very early January by 7%. This is explained by the fact that the statistical agency reported the Q4 inflation of 11.5%. And the second driver is bonus provisions. As I explained, again, in the very early January we established a provisioning pool for future bonus payments for the management team. Back in Q1 2014, there were no such provisions established. That explains the gap.

Your second question was about our inventories. Currently they stand at 13 mln carats. Whereas the breakdown of our inventories is fully in line with our production breakdown.

**Roman Gorokhov** – J.P. Morgan

Just a few questions from my end. The first one: in your press release, you mention lower activity from India in Q1, but looking at the statistics, other big midstream markets are also seeing somewhat declines in rough diamond imports, not just India. It is similar in China, the USA and Belgium. Can you give us some idea of the reason behind this?

**Igor Kulichik** (*translated*)

I believe you are talking about completely different metrics. The thing is you are referring to the consumption of jewelry with diamonds, whereas I am talking about the rough diamonds consumption. India reduced their off-take of rough uncut diamonds, but they kept selling from their stocks to provide jewelry with diamonds. That explains the difference.

**Roman Gorokhov** – J.P. Morgan

I am speaking about rough diamond imports based on customs statistics for the USA and for China as well as AWDC data for rough diamond imports.

**Igor Kulichik** (*translated*)

India is the acknowledged leader in the cutting and polishing business, hence it is so dominant in the market in terms of impact, in their volumes as well.

**Roman Gorokhov** – J.P. Morgan

Would you mind clarifying a bit on your statement of the market as more balanced after the 6% decline? My understanding is that polished diamonds have been weakening for a bit now. Are you stating a stabilisation or, maybe, reversal in this trend, where it might spur rough diamond demand again in the midstream?

**Igor Kulichik** (*translated*)

We would not go as far as producing a forward-looking forecast for the rough diamond pricing. What we want to state at this point is that the fluctuations or volatility that we saw in Q1 and the beginning of Q2 are now over.

**Roman Gorokhov** – J.P. Morgan

Do you see any purchases from Gokhran this year?

**Igor Kulichik** (*translated*)

We do not envisage any plans to sell to Gokhran this year.

**Boris Sinitsyn** – VTB Capital

Two questions from my side. The first one is on the sales volumes of Q2 2015. What are your expectations, for example, compared with Q2 last year? And please reiterate the sales guidance for 2015. And the second question is on your sales mix. Should we expect the same favourable change in your sales mix going forward, offsetting the negative movement in the market price, or will you stick to maintaining your inventory close to your production mix? Thank you.

**Igor Kulichik** (*translated*)

Considering Q2, it is not over yet. We are working within the targets originally set forth. As to the year of 2015, full year I mean, our original guidance of 40 mln still stands; we have not changed that expectation so far. If there is any change to be expected, that would come in Q3 this year as we do the budget adjustment exercise following the results of the first 6M.

As to the second question on the sales mix, the sales mix may change quarter-to-quarter, but if look at the full-year mix historically, you will see that it has always been the same.

**Oleg Petropavlovskiy** – BCS

Two questions from me. Can you please confirm or change your 2015 capex plan? And also can you please give us some more colour about your non-core assets, including gas assets? What progress is there?

**Igor Kulichik** (*translated*)

Considering your first question, our capex plan for 2015 stands at RUB 36 bn. It has not been and will not be adjusted.

Let me give you a more granular view on the divestment from the non-core assets. Earlier in the year, we sold one of the last major assets, which was our MAK-bank. And the remaining assets include gas assets and Vilyuiskaya HPP-3. These assets are rather difficult to sell for natural reasons. As to the HPP, it has only one natural buyer, which is RusHydro. We are involved in the process of rather extended alignment of contractual terms and conditions.

Whereas with the gas assets, the degree of uncertainty is somewhat higher. As you are aware, we are currently in a deal with Rosneft. There is discrepancy between ours and Rosneft's geological survey teams as to the evaluation of the reserves. As agreed with Rosneft, we are currently drilling two more exploration wells to prove or disprove the current reserves on the balance sheet of the gas assets. These efforts will be finalised early in 2016.

Following interpretation of the obtained data, we will get back to the negotiation table with Rosneft to discuss potential terms of the deal. I can tell you that the probability is quite high that this deal will not be finalised in 2015, and that if it is finalised, it will be in 2016. Please note, however, that the gas assets do not represent a burden for the Company since they generate free cash flow and profit, hence holding those assets is not an issue.

Thank you for your questions and your attention. If you come up with any further follow-ups in the future, you are welcome to submit those in writing and we will be happy to revert to you. Thank you for taking the time on the call, and good-bye.