Good day, everyone, and welcome to ALROSA’s conference call on Q2 and H1 2015 results. I am Sergei Mezhokh, Head of IR, and I will make few introductory notes. First of all, our top management today is led by our CFO Igor Kulichik. We have prepared several slides for you, which are on the website and have been e-mailed to you earlier, and we would refer to them while making this presentation.

Before we start, I would like to remind you, as usual, that some information provided during this call may include forward-looking statements that 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. ALROSA assumes no obligation and does not intend to update any such forward-looking statements. Now I pass the word to Igor Kulichik. Please.

Igor Kulichik (translated)

Colleagues, I am happy to welcome you on today’s call presenting ALROSA’s results for H1 2015. These results were to a great extent driven by a combination of the lower activity in the diamond market, on the one hand, and the developments in the FX market environment which continued to be in our favor, on the other hand.

In the reporting period, the Group’s revenue was up by 26% to RUB 132 bn, EBITDA was up by 49% to RUB 70.5 bn and EBITDA margin increased to 53%.

The free cash flow was RUB 35.4 bn, up 72% y-o-y. The net debt at the end of H1 2015 was down by 20% at RUB 140.8 bn, with the net debt / EBITDA ratio at just 1.2x.

ALROSA’s revenue growth in H1 2015, by 26% y-o-y was mainly driven by the increase in revenue from diamond sales by RUB 27 bn, of which RUB 25 bn was from gem-quality diamonds.

Now a few words about the current market environment. The diamond market fundamentals are largely driven by the recent slowdown trend in the global economy as well as in the key regions of jewellery
consumption, with both US and China expected to see slower growth of their economies and middle class numbers in 2015 vs the previous year.

Overall, 2015 is expected to see a decline in the demand for diamond jewellery by 0.5% vs 2014, whereas in 2011–2013 the average annual growth rate of the global diamond jewellery market was approximately 11%. Lower activity in the diamond jewellery market has led to a lower demand from Indian cutters and polishers, driving down the diamond prices.

ALROSA implemented two price cuts for its products over H1 2015, in February by 3% and in May by a further 3%, a total of 6% by July 2015.

Our outlook for the diamond market fundamentals remains moderately conservative. We uphold our previously announced view that we expect no meaningful price increases in the diamond market in the mid-term with a diamond supply decrease after 2018.

As for our sales tactics, we undertake an ongoing monitoring of the diamond market and make sales decisions based on the actual demand environment. In the recent months, we have pursued a strategy of maintaining prices by offering scarcer supply.

The revenue from gem quality rough diamond sales was 28% higher y-o-y in H1 2015, mainly due to the weakening of the ruble against the US dollar. The average realized prices were a bit lower that in the same period last year due to both changes in product mix as well as lower prices. Lower demand for rough diamonds can be well illustrated by our sales performance in Q2 2015 vs Q1 2015, with revenue down 27% q-o-q, mainly due to lower carat sales volumes.

The higher production costs were mostly driven by higher wages, salaries and other staff costs, depreciation, extraction tax (MET) and fuel and energy costs.

Wages, salaries and other staff costs were almost RUB 21 bn, up 24% y-o-y, as a result of the indexation early in the year by 7% to reflect the significant ruble weakening, as well as the higher accrual in 2015 of provisions for year-end employee bonuses, which included the so-called 13th and 14th monthly pay, whereas the 2014 provision was only for the 13th monthly pay. The actual decision on awarding these bonuses will be made based on the full-year performance of the Company.

Mineral extraction tax, or MET costs, were RUB 11 bn in H1 2015, up 69% y-o-y, driven by two factors. The Russian Ministry of Finance had introduced a new price list for MET calculation on 15 March 2014, with a 35% price increase. Also, this price list is US dollar denominated, and in ruble actual tax costs became higher as the national currency weakened.

The higher depreciation was caused by higher ALROSA’s production in carats, including the launch of production facilities at Severalmaz, Udachny underground mine and the coming on stream of the Botuobinskaya open pit.

The fuel and energy costs were RUB 8.6 bn, up 42% y-o-y, mainly due to the changed arrangement for the electric power purchase from ALROSA’s subsidiary, Vilyuiskaya hydro power plant, or Vilyuiskaya HPP-3.

Last year electric power sales income of Vilyuiskaya HPP-3 and ALROSA’s costs for its purchase from Vilyuiskaya HPP-3 were classified as intercompany and as such did not appear in ALROSA’s financial statements.

Starting from 2015, Vilyuiskaya HPP-3 sells electric power to Yakutskenergo, which is the largest power company in the Far East, and ALROSA purchases electric power from Yakutskenergo. As a result, in ALROSA’s financial statements other revenue increased by over RUB 1 bn reflecting sales from Vilyuiskaya HPP-3 to Yakutskenergo. But the cost section now also includes respective costs. On a net basis, this is rather a reclassification of costs, not the actual increase.

As I already mentioned, the weakening of the ruble vs US dollar is the main growth driver of EBITDA and net profit in H1 2015 y-o-y. I would also like to note that, as a result of the strengthening of the ruble to the US dollar in Q2 2015, the Company generated additional FX gain as a result of evaluation of a portion of its debt portfolio denominated in US dollars.
The Company's capex in H1 2015 was down by 4% y-o-y to RUB 15.6 bn. The reason for the reduction were lower capex in production facilities such as Udachny underground mine and Severalmaz. The Company increased its investment in the working capital by approx. RUB 10 bn, mainly due to the increase in the ore and concentrate inventory, as well as advanced payments for oil products due to the weakening of the ruble. Ore and concentrate inventory increased due to the beginning of production at Botuobinskaya pipe and Karpinskogo-1 pipe at Severalmaz, the underground mine of Udachnaya pipe, as well as a longer than planned maintenance at beneficiation plant No. 8 of Aikhal division. The main driver for free cash flow growth by 72% to RUB 35 bn was the higher operating income as a result of the weakening of the ruble against the US dollar. Following the repayment of bonds for a total amount of RUB 10 bn in June 2015, our total debt went down to USD 3.3 bn as at the end of H1 2015. In the course of H1 2015, ALROSA created a source of liquidity for its upcoming repayment of bonds for another RUB 10 bn in October 2015. This completes my presentation, and we are now opening our Q&A session. Thank you.
Questions and Answers

Neri Tollardo – Morgan Stanley

The first question is on your sales strategy. You have mentioned that you have effectively chosen the price-over-volume strategy in the recent months, but there has been news that your key competitor, De Beers, has lowered prices by 8% to 10% at the latest sight. Do you feel any pressure to lower your prices and potentially increase your volumes a little bit, and do you have an updated sales guidance for this year, or do you plan to, maybe, engage Gokhran (State Precious Metals and Gems Repository) to sell some volumes in 2015?

My second question is on your pricing. You have said that the prices have fallen by about 6% YTD, as far as I understand, that is for your long-term customers. Can you give us an idea of how the prices for your auctions and spot sales have moved since the beginning of the year?

And the last question is on your working capital changes. In H1 2015, we saw some sizeable working capital accumulation. What can we expect in H2 2015, especially considering the high deferrals that we have heard about in the news?

Igor Kulichik (translated)

If you look at our sales numbers and that of De Beers, they will be very similar. We have brought down our sales volumes as well as prices on a very similar scale. We are obviously the largest sellers in this market, so we now feel the market very well and our steps are very similar. It would not be entirely appropriate to say that we maintain prices, favouring price over volume. In fact, we use both of these levers, so we can adjust both the price and the volume. We believe that we will continue with this strategy in H2 2015. Currently, we do not see any signs of the market getting stronger, and it will continue to be very lax in H2 2015. I will not be mentioning the H2 2015 sales numbers now, but they will certainly be adjusted vs the original plan. As for prices for H2 2015, we have monthly meetings of our market environment body that looks at the market environment and adjusts prices, and we will continue to do this.

As for the price difference for different categories of customers, actually, there is no difference for our long-term customers compared to our auctions and spot prices. In fact, our long-term customers most often act in more than one capacity: in addition to being long-term customers, they also participate in spot sales. And now, at the beginning of September, we have various auctions and bids and tenders running that will give us indicative prices, and based on that we will come up with our proposals for the autumn.

Your third question was about our working capital. It is quite possible that the working capital will increase in the second half of the year, basically, for the same reason – our inventories of ores and sands mined may go up.

Des Kilalea – RBC

I have a follow-up to the last questions. Could you provide us with some information on your current inventory in carats and at market value and tell us if you would, considering the weakness in the market, resort to selling more rough diamonds to Gokhran in order to fund your cash flow? Thank you.

Igor Kulichik (translated)

Our inventory currently stands at 17 mln carats, of which 11 mln is gem-quality rough diamonds and 6 mln is industrial rough diamonds. We do not intend to address Gokhran asking them to purchase any volumes
from us. In fact, that would be strange for a company such as ours, which has free cash flow booming, to approach the government for any assistance.

Roman Gorokhov – J.P. Morgan

Just one question from me. I was wondering if you have a general idea of how high the downstream inventory is at the moment. I understand you probably cannot provide exact figures, but could you give us an idea of whether you think it is larger or smaller than the average for this time of year? Do you think the inventory level in the midstream and the retail sector is higher than usual at this point of the year?

Igor Kulichik (translated)

Talking about the inventory of retailers, jewellers, cutters, and polishers, we can only guess, as they do not publish their numbers, but from what we hear from the market, they may have quite high inventories now. In fact, high inventories of jewellers may be one of the factors of the slowdown in the market. Purchases of rough diamonds have gone down, and we expect this trend to continue until the year-end.

Roman Gorokhov – J.P. Morgan

Would you expect this to affect holiday sales? Would you expect inventory to be unwound in the midstream and the retail sector, which would then probably translate into lower rough diamond purchases for the holiday season?

Igor Kulichik (translated)

If we knew answers to the questions you are asking, we would probably be three times as effective and efficient as we are now. Of course, we hope that, in anticipation of Christmas and New Year, purchases will go up, but this may well not happen. Please note that you do not need to pay too much attention to fluctuations within a year. It is only market players, such as us, De Beers, and others, who see them. The situation changes a lot quarter-to-quarter. I suggest that you look at full-year numbers. In the same way as we looked at 2014, we will take a look at 2015 when it ends and make conclusions.

Nikolay Sosnovskiy – UBS

First of all, a follow-up on your working capital and inventories. You have recorded a 20% increase in the diamond inventories since the beginning of 2015. Concerning this increase, are you planning any scaling down of production in order to save the working capital and not to increase it any further because the final market is weak, as you have mentioned.

Igor Kulichik (translated)

As we have mentioned many times, if we reduce production our costs will increase so it will be much better for us to keep production stable and increase inventories rather than bring down production. So it is quite probable that our inventory will increase a bit further by year-end.

Nikolay Sosnovskiy – UBS

The second question is a follow-up on your sales. You have mentioned that ALROSA had a 6% price reduction in H1 2015, but you did not comment on deferral volumes. Could you please disclose, if possible, what deferrals were in H1 2015 and, if any, in H2 2015 up until the current date?
Igor Kulichik (translated)

The percentage of products that we allow our clients to defer or reject from taking is one of our mechanisms of influencing the market. And that share in H1 2015 was in the range of 0% to 50%. I cannot tell you now what deferrals will be allowed in H2 2015, because we have to wait until the results of the auctions in September.

Nikolay Sosnovskiy – UBS

But in July and August, did you have any significant deferrals within this range up to 50% or were these two months more or less OK?

Igor Kulichik (translated)

In July, we did have deferrals up to 50%. July and August are traditionally quite weak months because this is a holiday season and there are very few clients in the market. If you look at our monthly breakdown historically, you will see that in these two months we have very low sales.

Nikolay Sosnovskiy – UBS

Just to clarify, up to 50% deferrals in July is compared with the normalised H1 2015 or July 2014?

Igor Kulichik (translated)

The way deferrals or refusals work is that clients may refuse to take up to a half of what is offered in any trading session. That means that in July the clients actually refused to take half of what was offered in July.

Mikhail Priklonsky – Credit Suisse

I have one follow-up to the question asked earlier. You have mentioned that you and De Beers tend to make similar steps when you make decisions on prices and volumes. Given that De Beers has reduced its prices by 9% in their August auction, does it mean that ALROSA will have to do a similar cut in the early September auctions?

Igor Kulichik (translated)

That would be a too general statement to say that De Beers reduced their price by 9% on their August auction. The fact is that they put on the auction very specific goods, very peculiar goods, and a very low volume. The price reduction was on just very special positions and the market does not know which ones. So, it will be too bold to say that the reduction was 9% across. Yes, we and De Beers have obviously the same instruments of working in the market and we are now holding auctions and doing test sales. Depending on the outcome of what we will see, we will set prices at our September auctions.

Thank you very much for your attention. If you have any questions, please do not hesitate to follow-up and we will meet you in our 3Q and 9M 2015 results presentation. Thank you once again.