



ALROSA

ALROSA Q3 and 9M 2015
IFRS results conference call
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ALROSA speakers

Ilya Ryashchin – First vice president

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Participants asking questions

Nikolay Sosnovskiy – UBS

Des Kilalea – RBC

Boris Sinitsyn – VTB Capital

George Buzhenitsa – Deutsche Bank

Eduard Faritov – Bank of America Merrill Lynch

Stella Cridge – Barclays

Vahe Ovasapyan – Goldman Sachs

Presentation

Sergei Mezhokh

Good day, everyone, and welcome to ALROSA's conference call on Q3 and 9M 2015 results. I am Sergei Mezhokh, Head of IR, and I will make a few introductory notes. Our top management is led today by Ilya Ryashchin, First vice president. We have prepared several slides for you, which are already uploaded to ALROSA's website and have been e-mailed to you earlier. We would refer to them while making this presentation.

Before we start, I would like to remind you, as usual, that the information we provide in this call may include forward-looking statements that may involve some risks, uncertainties, and assumptions, and we assume no obligation for updating such forward-looking statements. Now I pass the word to Ilya Ryashchin. Please.

Ilya Ryashchin (*translated*)

Colleagues, we are happy to welcome you to ALROSA's Q3 and 9M 2015 results call. Let us start with our key financial highlights. In 9M 2015, the revenue went up by 17% y-o-y to hit RUB 173 bn, the EBITDA increased by 36% y-o-y to RUB 90 bn, while the EBITDA margin reached 52%. Our revenue increased by 17% y-o-y even though diamond sales went down in carat terms by 20% y-o-y that was offset by the USD/RUB rate which boosted our financial performance in 9M 2015.

Let me say a few words about the uneasy situation in the diamond market. In Q3 2015, we saw a rare demand for rough diamonds from Indian cutters and polishers due to the fact they had established stocks back in 2014 linked to their excessive upside expectations for diamond jewellery sales. If we look at the actual consumption in 2014–2015, the demand side of diamond jewellery went up by just 1 to 3% as was the case for other luxury products compared to a 10% growth after the 2008 crisis and related expectations

but the decline in demand is related to lower off-take in China. The key driver behind the reduced global demand for diamond jewellery is lower demand in China due to a more sustainable economic development and slower economic growth pace in that particular region complemented with temporary drivers such as instability in the financial markets, lower consumer confidence and weaker yuan.

ALROSA's sales prices have been reduced three times in the course of 2015, with a minus 3% step in February followed by the same step in May and another 8% reduction in mid-September. By now, ALROSA's sales prices have gone down by 15% year-to-date and are on par with the 2011 levels. Looking back historically after such a major slump the prices used to rebound within 18–24 months and in 2016 we expect the situation in this market to become more stable following that historical pattern.

On the expenses side, the increased cash costs were mainly driven by higher payroll expenses, payments for the mineral extraction tax (MET), fuel and energy as well as materials. The wages, salaries and other staff costs have gone up by 23% y-o-y to reach RUB 31 bn. This comes as a result of annual salary adjustments early in the year by 7% as well as salary provisioning we had to do in the course of 2015. Please mark that our wages, salaries and other staff costs remained flat q-o-q.

The MET payments for 9M 2015 reached RUB 17 bn, up 71% y-o-y, which is explained by weak ruble vis-à-vis the US dollar.

The fuel and energy costs reached RUB 12 bn in 9M 2015, up 30% y-o-y, explained primarily by a new arrangement for electric power supply from Vilyuiskaya hydro power plant, or Vilyuiskaya HPP-3. In the past, those were accounted for as intragroup costs.

Materials costs reached RUB 8 bn, up 22% y-o-y, due to the increased scope of work, as we are commissioning new facilities, and also cost inflation.

Transport costs declined by 28% in 9M 2015, which is explained by their comparison against 2014 when the base was higher due to excessive transportation expenses as road transport was used due to constrained navigation.

As I already explained, weaker Russian ruble vis-à-vis the US dollar is the key driver behind the improvement of our financials. I would like to note specifically that the Company managed to reduce its expenses in Q3 q-o-q in line and on par with the sales reduction that enabled us to keep our profitability at 48%.

Our capex in 9M 2015 went up slightly to reach RUB 25 bn, mostly driven by the capex for technical upgrade and maintenance of our production facilities. Reduction of the expansion capex is due to already commissioned facilities at such projects as Botuobinskaya pipe, stage one of the Udachny underground mine and Karpinskogo-1 pipe at Severalmaz facility.

Investments in working capital have increased by RUB 11 bn due to higher inventories built up due to lower activities in the global diamond market.

Our free cash flow is up 59% to RUB 36 bn due to higher operating profit related again to the weakening of the ruble against the US dollar.

Following the repayment of traded bonds for the total amount of RUB 10 bn in October 2015, our loans and borrowings now stand at USD 3 bn. Since the start of 2015, ALROSA has managed to reduce its debt by nearly USD 500 mln.

To complete my presentation, I would like to note specifically that even though the situation in the global rough diamond market remains uneasy, ALROSA's successful tactics helped us to maintain our KPIs almost flat and remain efficient in this environment. Thank you.

This completes my presentation, and we are happy to start the Q&A session.

Questions and Answers

Nikolay Sosnovskiy – UBS

How do you view De Beers' November sight, which was only USD 70 mln? Is it sustainable? What was your November sight in this respect?

Ilya Ryashchin (translated)

It is hard for me to comment on De Beers results and the trouble is that the numbers are not available yet, it is more of a rough understanding of the situation. But we can definitely assume that November and December sales volumes will be very low, probably some 30%–40% of the normal levels we saw in the recent years. Currently diamond producers stick to constraining supply side policy because we have to admit that the price reductions in the course of 9M 2015 have not revived the market. We see large inventories of cut diamonds both on the cutter side and on the side of jewellery manufacturers. It would take some time to work through all the inventories reducing their levels and having the situation back to normal. As I have mentioned earlier we expect the market to become more stable in 2016.

Nikolay Sosnovskiy – UBS

You are obviously producing more than selling. If the situations continues in Q4 2015 and Q1 2016, what would be the overall level of your diamond inventories in carats? What would be the critical level, the level that you do not want to surpass?

Ilya Ryashchin (translated)

We have always explained that we see the normal level of inventories at 12–14 mln carats. Currently the inventories stand in excess of 20 mln. Increasing the inventories further would be difficult economically for the Company. In case 2016 does not bring the consumption levels back to normal we would probably reconsider production volumes. Looking ahead into 2016, we are considering different options, and one of the options we analyse is related to constrained production. It is too early to give any numbers at this point. We will be monitoring the situation and making decisions as it develops.

Nikolay Sosnovskiy – UBS

Assuming this challenging market, are you planning to reduce your capex or postpone any developments?

Ilya Ryashchin (translated)

So far we have been moving along the lines initially planned in our strategy and we keep going like that. But again given the market environment and the investments required we would probably consider postponing some projects. We will look at them in Q1 2016. Commenting on the capex in general I would say that diamond production usually involves long-term projects and obviously with the 10-year strategy ahead of us decisions like that would probably not be the most optimal because if we invest now quite a few projects would only bring in some bottom line beyond 2020. We will be closely watching the situation and making decisions in Q1 or based on Q1 results.

Des Kilalea – RBC

Could you give us an idea of what the market value of the inventory might be at today's prices?

We also know that De Beers decided to spend a little more on marketing over Christmas. What is ALROSA's plan on marketing?

Ilya Ryashchin (translated)

Speaking of the value of the inventories, it is more than USD 2 bn.

Regarding your question on diamond marketing, we hardly sell any cut diamonds at all, we only sell rough diamonds. In that sense, ALROSA is not expecting to start a campaign of any kind. But we are part of the Diamond Producers Association that will meet in January to discuss its FY marketing plan. That will be a marketing effort done jointly together with De Beers, Rio Tinto and a few other producers.

Boris Sinitsyn – VTB Capital

We have noticed that the prices for gem quality diamonds were quite robust throughout the year, despite decreasing average market prices, meaning that the product mix within gem quality diamonds was constantly improving. Should we expect some kind of normalisation of the product mix within gem quality diamond volumes meaning that this might have negative effect on prices in Q4 2015 and 1H 2016?

Ilya Ryashchin (translated)

We have seen no major change in the mix. We sell sustainably what we produce. And I would not agree with your view that gem quality prices were quite robust as you said. We made reductions three times this year and that was done by pretty much all diamond producers at around the same time. In that sense, we are aligned with the market.

Boris Sinitsyn – VTB Capital

I was referring to the average gem quality diamond prices which you report and which increased 13% in Q3 2015 vs Q1 2015. That is why on the back of the negative price trend on the market on average our understanding was that it means better gem quality diamond mix.

Ilya Ryashchin (translated)

The average price per carat may fluctuate, as you rightly put it, depending on the product mix, seasonality, availability of beneficiation capacities, which may be related to stoppages, maintenance, etc. However, I would like to underline it yet again, in 9M 2015 we have not introduced any changes into the mix and we have been selling sustainably.

Boris Sinitsyn – VTB Capital

We saw some substantial FX charges in 9M 2015. Should we expect these FX charges to affect your decision on final dividend distribution in 2015 as it was last year when net income was adjusted for FX movements in 2014?

Ilya Ryashchin (translated)

The situation this year is radically different from the last year when the fluctuations were much more significant and hence the FX losses were much greater. Indeed FX losses are rather significant this year as well but given the overall performance of the Company which is positive regardless of the market developments we will be making our decision on the dividends at a later point based on that.

To start with, our net income has reached RUB 32 bn in 9M 2015, which already factors in all the FX losses related to the dollar going up to 65 rubles.

George Buzhenitsa – *Deutsche Bank*

You have mentioned that you are developing a number of scenarios with respect to production and sales of diamonds in 2016, should the current market backdrop persist. Does any of them involve possible sale of diamonds to Gokhran?

Do you see scope for reduction in your payroll expenses going into 2016 vs 2015 in ruble terms?

Ilya Ryashchin (translated)

Looking into 2016 options, Gokhran could be an option but even if it happens, it would not be significant enough to affect budget volumes. When considering our developments into the next year we look after the market, first and foremost.

Speaking of payroll expenses, we employ about 30,000 people, most of them production personnel. They definitely do not deserve wages or salary cut in rouble terms. For the top managers and the administration, everything is possible here, to be decided by the Supervising Board.

Eduard Faritov – *Bank of America Merrill Lynch*

Shall we expect some write-down on your stockpile so that the quality of the remaining diamond stockpile is lower?

Ilya Ryashchin (translated)

Our prices on the average are stable and if we consider any variations from quarter to quarter or over a broader time period, they would be related to seasonal changes or availability of beneficiation capacities given stoppages, maintenance, etc. These are the sole drivers for fluctuations in our average realized price. If we consider our full-year sales mix, it is very sustainable. There is no ground to consider any change in the valuation of our inventories. The average value of the mix in the inventories has been fairly stable.

Eduard Faritov – *Bank of America Merrill Lynch*

Does it mean that your sales policy does not admit changing the sales mix of your diamonds by choice?

Ilya Ryashchin (translated)

We do not have any formal rule preventing that and cannot have it. The market is a living thing and the demand may vary for this or that particular part of the mix depending on the situation on the market. However, if we consider a larger time span of, let us say, a year, you will see that the average realized price, and hence, the average mix, remains unchanged. It would be wrong to ask the question in this particular way – it is not that some part of the mix is of higher quality whereas another part of the mix is of lower quality. It is just that the market demand may vary for this particular part of the mix. For example, there could be more demand for a cheaper part of the mix. Our sales policy is based on long-term contracts, and that effectively describes and defines our production mix, the mix is defined in this context.

Stella Cridge – *Barclays*

What are your plans for the debt maturing early next year? I noticed at the end of the last reporting period cash had fallen slightly below short-term debt, so would you plan to refinance this debt to try to keep cash on the balance sheet and just to conserve the credit schemes in the current market conditions?

Ilya Ryashchin (translated)

In 1H 2016, we do expect to pay out about USD 300 mln of smaller loans, that is true.

Vahe Ovasapyan – *Goldman Sachs*

What should be the catalyst for the market to stabilize the next year? Do you see any improvement in demand? What is your guidance on sales volumes. Do you have some cost optimization program and in what way could it affect your cost side?

Ilya Ryashchin (*translated*)

As I said, considering 2016 market improvements, the key and fundamental driver is the consumption volume of diamond jewellery, which is still growing at not that high pace but still up. Again, if you look at the growth expectations in the key markets, it is not that high but still an increase. That increased demand for diamond jewellery cannot but transit into rough diamond demand increase. Our estimations supported by the industry experts demonstrate that reduced supply side in 2015 has helped significantly to reduce inventories for both cutters and jewellery manufacturers. Speaking of the 2015 full year numbers, I would not comment on those at this particular point in time, but if you look at other highlights and financial indicators such as margins and profitability, they remain quite high despite the reduced sales volumes. In terms of cost and investments optimization, we have dedicated plans to this effect for 2016. The scenarios vary, but as we see, the cost impact would be about RUB 10 bn.

Ilya Ryashchin (*translated*)

Colleagues, I would like to thank you for your attention and your participation. Even though the situation in the market remains uneasy, on behalf of the management team I would like to assure you that the Company would respond to the developments of that situation in an effective and reasonable manner. Despite the market turbulence, we hope to be satisfied with 2015 numbers and we expect further improvements looking ahead into 2016. Thank you again.