



ALROSA

ALROSA 2015 IFRS results
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ALROSA speakers

Andrey Zharkov – CEO

Igor Kulichik – CFO

Timofey Rodchenkov – Head of Investor Relations

Participants asking questions

Neri Tollardo – Morgan Stanley

Des Kilalea – RBC

Sergey Donskoy – Société Générale

Boris Sinitsyn – VTB Capital

Ksenia Mishankina – UBS

Andrey Lobazov – ATON

Irina Elizarovskaya – Raiffeisen Bank

Presentation

Timofey Rodchenkov

Good day, ladies and gentlemen, and welcome to ALROSA's conference call on 2015 results. I am Timofey Rodchenkov, Head of IR, and I will make a few introductory notes. Our top management is represented today by Andrey Zharkov, CEO, Igor Kulichik, CFO. We have prepared several slides for you, which can be found at 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 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 Andrey Zharkov. Please.

Andrey Zharkov (*translated*)

Good day, ladies and gentlemen, I am happy to welcome you today at our conference call to disclose FY 2015 results. At 9 a.m. Moscow time we disclosed our IR-release on FY 2015 performance, and I hope you are satisfied and happy with it.

As of the end of 2015, ALROSA demonstrated an increase in its operating and financial performance. Diamond production increased by 6%, whereas sales revenue in ruble terms went up by 8%, although, unfortunately, in US dollar terms it went down by 30%, which is explained, first and foremost, by the general market situation.

In 2015, ALROSA faced a decrease in demand for our main product, diamonds. It is explained by the fact that cutters and polishers in India had built up excessive inventories.

Thanks to measures undertaken in the market, including measures by ALROSA, to squeeze supply in H2 2015 and implement reasonable sales and marketing policy, today we see signs of recovered demand for rough diamonds. First and foremost, this recovery comes from Indian cutters and polishers. Well, “squeeze” may not be the best word choice here, because we actually were quite respectful and careful about the market conditions we saw last year, especially in H2 2015.

Market fundamentals in retail jewelry remain unchangingly attractive, and the demand in the core consuming region, the US, is increasing, although that growth is moderate.

In 2015, ALROSA continued implementing its diamond production strategy. The Company carried on with the construction of its fourth underground mine, Udachny. It resolved the excessive water cut issue at the Mir mine and continued to build infrastructure to develop the new field of Verkhne-Munskoye.

ALROSA also continued implementing its strategy to divest non-core assets. In 2015, we divested of five businesses outside of our core business framework, and the total size of these divestments stands at around RUB 300 mln.

We continue active efforts to divest two non-core assets, namely the gas asset in Western Siberia and Vilyuiskaya-3 hydro power plant.

As for the core 2015 numbers, our net profit stood at RUB 32 bn, whereas free cash flow stood at RUB 41 bn.

At this point, I would like to pass the word to Igor Kulichik, ALROSA’s CFO. Thank you for your attention.

Igor Kulichik (*translated*)

Good day, ladies and gentlemen, let us proceed to discuss our financial results for 2015.

Despite the market uncertainty as of the end of 2015, ALROSA managed to demonstrate positive financial results. ALROSA’s revenue in 2015 stood at RUB 224.5 bn, which represents an 8% increase y-o-y, whereas our EBITDA amounted to RUB 118.5 bn, a 26% increase vs 2014. The increase in both sales revenue and EBITDA has been reflected in the record high EBITDA margin, which stood at 53%.

The increase in the ALROSA Sales revenue in 2015 was first and foremost accounted for by the increased revenue from gem quality rough diamond sales.

Despite the fact that gem quality rough diamond sales in carat terms went down by 29%, the decrease in sales volumes was offset by the weakening of the Russian ruble against the US dollar.

The key drivers behind the increased production costs are the extraction tax, wages, salaries and other staff expenses, fuel and energy, and materials.

The main contributor to the increased production costs was the extraction tax, as this line is directly related to fluctuations of the ruble against the US dollar. The increase in extraction tax expenses by 59% translates from the stronger US dollar vis-à-vis the Russian rouble.

Expenses on salaries and wages went up by 17%, first and foremost due to the salary adjustments by the official level of consumer inflation standing at 12%. On top of that, we commenced diamond production at Karpinskogo-1 pipe and the Udachny underground mine, and that required a higher number of employees at the Udachny mining division and Severalmaz division.

The increased volume of operations at the production sites I have just mentioned caused not only an increase in salaries and wages, but also in expenses for fuel and electric power – by 29% in total.

Not only did we commence operations at new facilities, but we also expanded our volumes at an existing facility, the Mir pipe, following the measures to reduce water cut.

Our EBITDA in 2015 went up by 26% to reach RUB 118.5 bn.

Following the reduced FX losses, which went down by RUB 24 bn, and the increased EBITDA, ALROSA’s net profit amounted to RUB 32.2 bn in 2015 vis-à-vis a net loss of RUB 16.8 bn in 2014.

Our capex went down by 5% in line with the reduction of investments in production capacity expansion, which is part of the long-term strategy of ALROSA.

The key driver behind the lower capex was the successful commissioning of several major production facilities, such as the Botuobinskaya pipe, which was commissioned in Q4 2014, Karpinskogo-1 pipe at Seversalmaz division, which was commissioned in Q1 2015, and stage one of the Udachny underground mine, which was successfully launched in H2 2015.

At the same time, we undertook initial investments to develop two perspective production projects: we commenced construction of the open pit mine at the Zarya pipe, and built a road to reach out to Verkhne-Munskoye field, 170 km away from the Udachny settlement.

As of the end of 2015, ALROSA increased its stock of diamonds by more than 8 mln carats, following the reduced demand for diamonds on the part of the off-takers, cutters and polishers. That explains the increase in our investments into working capital to RUB 34 bn.

The increase in our working capital was almost fully offset by the increased profits from operations. As a result, our free cash flow in 2015 amounted to RUB 41.3 bn.

Our debt analysis reflects the sustainable strategy of ALROSA to reduce its debt burden. The total debt to EBITDA ratio went down below 2x, following the payout of corporate and traded bonds for the amount of RUB 20 bn in 2015.

This concludes my presentation, and I suggest that we start the Q&A session. Thank you.

Questions and Answers

Neri Tollardo – *Morgan Stanley*

A few questions from my side, starting with the market outlook. We have seen a pretty strong start of the year, with a sequential increase in rough diamond volumes in January and February. Could you give us any outlook for the rest of the year? And could you reiterate your rumored sales budget of USD 3.5 bn in 2016 (I believe it was mentioned in December)? My second question is on your dividend policy. Your full year results were released today. When can we expect to hear about the dividend payment related to 2015? And my third question is on capex. First, I believe you were a little bit below the capex guidance for the year. Is it just optimization or is it postponing of some of the capex? Second, speaking of Verkhne-Munskoye field and the Zarya pipe, how much investment do you expect there in 2016?

Andrey Zharkov (*translated*)

Indeed, the start of the year was quite strong, but we should not be too much obsessed with it, if I may put it this way. ALROSA retains a relatively cautious approach towards the full year results, and I would say USD 3.5+ bn in terms of our sales would be a good guidance ahead of the year. I would say that at this point, our task is not to increase our inventories as of the end of 2016. However, you are right saying that January and February were strong months indeed. It was the result of the responsible sales and marketing policy ALROSA undertook in H2 2015 towards its clients and the market.

Regarding the dividend policy, as you are aware, our approved dividend policy provides for no less than 35% of the IFRS net income as a dividend payout. This year, however, it could be expected to be up to 50% for the 2015 results.

In terms of our capital investments in 2015, the optimisation exercise for our expenses is never ending, and the fact that we went somewhat below our guidance for 2015 is a symbiotic merge of this optimisation exercise for the expense side and postponed projects that had been carried over from the end of 2014 into the following period.

Speaking of our expenditure for Verkhne-Munskoye field, the 2016 budget provides for about RUB 6 bn.

Des Kilalea – *RBC*

I have a couple of questions. The first is on the mineral extraction tax being based on the US dollar. Is it not possible to renegotiate back to the ruble? Because I am not sure it sounds logical to have it in dollars given the fluctuations in currencies. Secondly, could you give us an indication of total carats in inventory and the market value today? And finally, you talked about your divestments of gas assets. Are you still committed to holding on to Catoca, and would you consider or are you considering looking at Grib pipe which I am sure LUKOIL would probably like to sell?

Andrey Zharkov (*translated*)

The extraction tax is calculated as a share of value of rough diamonds produced, and that value is determined by the price list originally approved by the Ministry of Finance in US dollar terms, like for other commodities, e.g. precious metals. The price for those commodities is set by the global market, where all sales and trading hubs are located. However, payments are effected in rubles, as we pay taxes to the Russian Federation budget. So, the amount of that fair value is converted into rubles at the moment of accrual of this particular type of tax. Challenging this position at this point would be a useless effort, in my view, because the Ministry of Finance's price list is set, as I said, in US dollars, and this would be equivalent

to renegotiating a sales price for oil in ruble terms, which is highly unlikely. In that case, we would need to develop our own independent pricing quotes, which can be too hard because the key consumption centres are outside of Russia.

As of the end of 2015 our inventories stood at 22 mln carats and slightly more than USD 2.5 bn in money terms. If you are asking about the current value, given the fluctuations in the market we have been observing, indeed, it has been influenced by the successful start of the year, as we explained by responding to the previous question.

We maintain a continued dialogue with market players in the gas industry who could be potentially interested in acquiring our gas assets, but at this point we do not have any particular M&A targets. Nor do we have a target to increase our stake in any other enterprise that we currently own. The Company has no specific M&A plan at this point in time. Proceeds from divestments of our non-core assets will be used to pay off the existing debt for the benefit of driving the shareholder value.

Sergey Donskoy – Société Générale

First of all, I would like to clarify one thing about dividends. You mentioned that in respect of last year the Company could pay up to 50% of the net income. Are you going to adjust this net income for the FX losses, which, if I am not mistaken, totalled around RUB 46–47 bn, or USD 700 mln, or are you going to pay 50% of the unadjusted IFRS net income? The second question: taking into account the significant inventory accumulation over the last year, are you going to somehow adjust your production targets for 2016, and what is your current production target? Do you have any ideas on 2017 in this respect? Also, speaking about guidance for this year, what capex do you have in mind? And lastly, could you give us some idea on the EBITDA of ALROSA's gas assets last year and in 2014 for comparison? What were the production levels and what production do you expect this year?

Andrey Zharkov (translated)

The approved dividend policy provides for payments of the net income under IFRS, and the IFRS net income already accounts for FX losses. So, my answer to your question is very straightforward: we are going to pay up to 50% of the IFRS net income, which is unadjusted for FX. This adjustment matter is raised from time to time, including by independent directors who are members of the Supervisory Board, and it is up to the Supervisory Board, it is fully within their scope of competence and their authority. They can consider this matter and decide accordingly.

Our capex chart is pretty much flat y-o-y, so the tentative 2016 capex will be pretty much within the range of 2015 with very insignificant variations. In terms of 2017, there will be a slight decline in that number.

As regards our production guidance for 2016 onwards, we currently have two scenarios providing for a range of 34–39 mln carats of production in 2016. The decision is to be made rather soon, and we have an option to potentially reduce production volumes. Our target is not to increase the Company's inventories, i.e. to sell 100% of what we produce in 2016 and possibly cut into our existing inventories, so that our sales are higher than the production volumes this year.

Speaking about the gas assets, their EBITDA in 2015 stood at RUB 2 bn, whereas in 2014 it was higher, about RUB 3 bn. This is related to different mineral extraction tax rules and an associated tax burden increases. Nevertheless, the EBITDA margin is still quite good at 30%–40% for these gas assets, and the net income stands at around RUB 1 bn. That is why we do not see any issue in selling these assets, and they do operate well, raising some good interest on the part of potential buyers.

Boris Sinitsyn — VTB Capital

The first question is on the product mix. You have mentioned that the share of industrial diamonds rose a bit in 2015 to roughly 34% of your total sales volume comparing with roughly 30% historically. Do you expect this share to normalize in 2016, with the share of industrial diamonds declining y-o-y? Another question is on your target net debt to EBITDA ratio. What is your comfortable target level going forward at which you may start to think about higher dividend payout ratio, like 30% this year, and start deleveraging?

Andrey Zharkov *(translated)*

Responding to your question regarding the sales mix, indeed, we have industrial diamonds as part of our sales. Industrial diamonds per se as a category do not contribute much to our revenue. I would say sales mix depends on the market situation and the fluctuations in demand, with more focus now on smaller and cheaper diamonds on the cut and polish diamonds side that is related to diamond jewelry. As in any market, we see fluctuations in demand, varying for different elements in the product mix. Sometimes there is more focus on one or three carat diamonds or on smaller stones. I do not think we should focus on that, as it is a usual float. However, generally we do note the migration of demand from larger and clearer stones into medium and smaller sized stones with lower clear color value.

Speaking of your second question about our target net debt to EBITDA ratio, we will pay out USD 350 mln scheduled at the end of 2016 when the debt matures. Our total debt will stay at USD 2.7 bn with the leverage below the level of 2x. This is a very good and comfortable level for the company given our revenue and the cash flow.

Ksenia Mishankina – UBS

ICould you please indicate your average price for diamonds in 2015? Could you please also comment on the news in the Russian press about the state plans to divest its stake in Alrosa? Then, you have mentioned your plans to repay the entire portion of your short-term debt. Do you plan to repay it using cash or any other sources?

Andrey Zharkov *(translated)*

We have accumulated more than USD 600 mln of cash and cash equivalents, so we are comfortable repaying the short-term debts this year.

The government is considering potential sale of about 10.9% of its stake through a public offering. This decision is currently being considered by the government and is to be indorsed by the president. We are waiting for the outcome of that process.

Speaking of our price per carat, there is no significant change y-o-y, and the level remains rather flat. In 2015, it stood at USD 115 per carat in our sales.

Andrey Lobazov – ATON

What maximum dividend payout ratio do you consider comfortable or acceptable for your balance sheet? I am speaking about the next two years, 2016 and 2017, and also about your dividend policy in the light of the possible privatization talks.

What do you think should happen to diamond prices or to diamond demand outlook to trigger changes in your long-term investment programme?

Andrey Zharkov *(translated)*

As you are aware, we are committed to no less than 35% of net income under IFRS, and this year we may see a payout of up to 50% of our net income. We are comfortable with this level in 2015 given our cash

flow. When it comes to future periods, 2017–2019 and beyond, let us stay away from forecasting at this point and let us see how it goes looking ahead.

Considering the other question on our capex and the correlation between our strategy and the market - it is not that simple or straightforward. As the market is so concentrated, there are not that many players and the focus stays with the few key majors. The products we make may be not that liquid but they are neither volatile. Given the market concentration, we believe it is possible to maintain stability in the market. This was demonstrated by actions taken in H2 2015 and early into this year. I would not say that our strategy is wrong. I would rather say that we are committed to our strategy and we reactivate this commitment at this point and in the longer term. As for potential tactical moves, we do have a whole range of instruments at our disposal. This can include potential postponing, reducing or not reducing the production that may be reasonable at each particular point in time. On top of that, we have a number of other instruments that come before any changes in the production side. We can work with our costs and we can improve a few other operational things rather than changing the strategy.

Irina Elizarovskaya – Raiffeisen Bank

Could you please provide an average selling price for your gem quality diamonds in Q4 2015? The second question is whether there were any changes or rather any improvement in the sales mix quarter to quarter. The last question is whether you have any refinancing plans for 2017. There seems to be a peak of USD 2.1 bn debt maturing by that time. Do you have any plans to issue Eurobonds or any other instruments?

Andrey Zharkov (translated)

Responding to your question on the sales mix, I would say that there are variations quarter to quarter. There are lots of factors, including seasonality, for example. The alluvial deposits do not produce early in the year, but they do have sales from the inventories. Our core pipes have seasonality as well, for example, overhaul and maintenance stops that do affect the mix. In terms of the average price for gem quality diamonds, it stands at USD 115 per carat across the year and it is more or less on that level on the average.

Igor Kulichik (translated)

Responding to your other question, you have rightly marked that there is a peak of USD 1.09 bn debt maturing in 2017. We are going to resolve this issue as early as in H2 2016 by carrying that maturity over into 2019 in the amount of USD 500–600 mln. 2019 does not have any major payments due according to the maturity profile and if we do this exercise carrying over USD 500–600 mln from 2016 into 2019 we will have a very comfortable and flat maturity curve.

Irina Elizarovskaya – Raiffeisen Bank

A follow-up on the first question. May we also talk about the reduction in price q-o-q? I mean in Q4, as there was a cut in September session, at the end of 3Q.

Andrey Zharkov (translated)

Indeed, in H2 2015 we saw a major price adjustment in September session. The overall price reduction for the full year stands at 15%, the largest portion of that falls on H2 2015.

Thank you very much, everybody. It was a great pleasure. Do not hesitate to buy Alrosa shares.