



ALROSA

ALROSA H1 2016 IFRS results
conference call edited transcript

30 August 2016

ALROSA speakers

Igor Kulichik – CFO

Timofey Rodchenkov – Head of Investor Relations

Participants asking questions

Des Kilalea – RBC Capital Markets

Boris Sinitsyn – VTB Capital

Ksenia Mishankina – UBS

Beatrice Bushati – East Capital

Mikhail Priklonsky – Credit Suisse

Denis Gabrielik – Otkritie Capital

Presentation

Timofey Rodchenkov

Good day, and welcome to ALROSA's conference call on H1 2016 IFRS results. I will make a few introductory notes.

Our top management team today is presented by Igor Kulichik, CFO, and Svetlana Linnik, Chief Accountant. We have prepared several slides, which are uploaded to our website and were e-mailed to you earlier. We would refer to them while making the presentation.

As always, I would like to remind you that the 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 floor to Igor Kulichik. Please.

Igor Kulichik (*translated*)

Colleagues, I am happy to welcome you to our H1 2016 results conference call.

The H1 2016 saw a significant recovery in the midstream demand for rough diamonds, which was reflected in ALROSA Group's financial performance. Strong financial results in Q2 allowed us succeed not just in delivery on par with the Q1 2016 results but also in outperforming some of them.

Despite the expected q-o-q decrease in Q2 2016 sales to USD 1.2 bn, they remain robust exceeding the first two quarters of 2015.

A relatively stable market environment in H1 2016 helped ALROSA prevent the prices from falling too sharply during the year. On top of that, ALROSA reduced its rough diamond inventories in H1 2016 by nearly 6 mln carats.

A sizable decrease in the working capital due to the reduced inventories was partially offset by a seasonal increase in the purchase of supplies and materials during the summer navigation period. As a result, ALROSA's working capital shrank by RUB 3 bn y-o-y.

ALROSA maintains moderately-conservative market outlook for H2 2016 on the back of a slight growth in diamond jewelry sales while also adhering to a lower production target of 37 mln carats set for FY 2016. To remind you, the Company has cut its 2016 production target in line with the sales performance by reducing production at the Mirny division alluvial deposits and at the Udachny underground mine.

ALROSA's key H1 2016 financial results are shown on pages 3–4.

The Group's revenue for H1 2016 was up 42% y-o-y to RUB 186.7 bn. The like-for-like growth in US dollar terms is 18%.

Our EBITDA increased by 58% y-o-y to RUB 111.3 bn, while EBITDA margin reached 60% exceeding the Q1 2016 record.

Pages 5–6 of the presentation discuss the changes in revenue. The 45% increase in revenue from diamond sales was driven by the sales volume growth of 21% and also by the ruble devaluation by 23% against the US dollar in the H1 2016 y-o-y.

Our production costs breakdown is shown on page 7. The increase in cost of sales in H1 2016 was in line with the larger sales volumes.

Wages and salaries went up 5%, mostly driven by the planned salaries and wages adjustment on par with the inflation rate in Russia.

The increase in depreciation and in materials costs was due to larger production at some of deposits including the Komsomolskaya pipe, the Udachny underground mine and alluvial placers of Almazy Anabara.

Pages 8–9 of the presentation show EBITDA and net profit bridge. In H1 2016 EBITDA was up 58% y-o-y and amounted to RUB 111.3 bn. ALROSA Group's net profit reached RUB 90.3 bn, which is a twofold increase y-o-y.

Our capex in Q2 2016 remains flat q-o-q as a result of further reduction in maintenance capex in line with ALROSA Group's plan for 2016.

The relative increase in expansion capex, as you can see on page 11, is due to the development of transportation infrastructure at the Verkhne-Munskoe deposit, which is located 170 km away from the settlement of Udachny.

Page 12 shows the breakdown of ALROSA Group's free cash flow. It reached RUB 78.7 bn, which represents a considerable increase y-o-y and was driven by stronger diamond sales.

Our debt and maturity profile is shown on page 13. In Q2 2016 ALROSA Group successfully repaid its short-term debt of USD 350 mln to Alfa-Bank. As a result, our total debt as of 30 June 2016 stood at USD 2.7 bn.

In addition, as a result of refinancing another loan from Alfa-Bank for a total of USD 720 mln, the share of short-term debt in our loans and borrowings went down to 14%.

Our net debt was RUB 153.5 mln. ALROSA has accumulated a total of RUB 47.6 bn in deposits with maturities of more than 90 days and these amounts are not included in the net debt calculation. As a result, the Company's total liquidity reaches almost RUB 70 bn, which means the Company has a safety cushion to protect itself in the current diamond market environment, and ALROSA can also comfortably continue

repaying loans and borrowings during the next year. This is reflected by the Company's credit ratings which, as you know, have been revised upwards by two agencies this year.

This concludes my presentation, and I suggest that we move on to the Q&A session now. Thank you!

Questions and Answers

Des Kilalea – RBC Capital Markets

If I could ask three questions, please. The first question: could you give us an idea of your outlook? You said that you had a cautious outlook for the diamond market in H2 2016. Perhaps, you could give us a little bit more detail on where you might see the prices going. And do you see that you may have to withhold any volumes?

The second one: could give us an idea of what inventory you now hold, maybe in carats and market value, given that you destocked nearly 6 mln carats in H1 2016?

The third question: is there any additional detail you can give on the two projects in Angola – Luaxe and... I am afraid I cannot pronounce the other one?

Igor Kulichik (translated)

As for your first question on the outlook for H2 2016, we expect no surprise. Actually, our outlook is pretty much conservative: we expect the prices to remain flat, and we expect no demand increases or decreases, no sharp changes, because all the fluctuations already happened back in Q1 2016. We expect H2 2016 to be smooth.

As for your second question, as at the end of H1 2016, our inventories amounted to 16 mln carats. That is USD 1.5 bn in US dollar terms.

Your third question about Angola. We are now running active geological and exploration work there. All the required licenses are in place, and we are also active in Botswana. I have said we are active, but the cash cost level is just within USD 5 mln, which is not much. In parallel, we are talking to Angola authorities to take out the so-called end-to-end license. To remind you, in accordance with that license, if we have some positive discovery of reserves, we can pass on straight to its production. This is basically it.

Boris Sinitsyn – VTB Capital

Several questions from my side. The first one is on your potential sale of non-core assets. What proceeds from the sale do you expect this year? The second question is on your deleveraging and, actually, on the debt leverage. What level of leverage, for example, Net Debt / EBITDA, do you feel is comfortable for the Company? In case of further deleveraging (with Net Debt / EBITDA close to 0), what would you consider – an increase in M&A activities or higher payouts in terms of dividends?

Igor Kulichik (translated)

As for the non-core asset proceeds, we do not expect any big cash-ins from that activity. The negotiations on our gas assets with Rosneft are at the same stage – we are now talking about the reserves confirmation. If this deal is closed, it is not going to happen this year. In parallel, we are talking with some prospective buyers, but this is for sure beyond this year as well. We have another non-core asset, Viluiskaya-3 HPP, and we are now talking to RusHydro to possibly dispose of it. This is a long process, and again, this is beyond the current year. In Angola, we also have a HPP called Hidrochicapa. This year, we are going to

sign an agency agreement to find a prospective purchaser for that asset. It is very hard to find one in Angola, so most likely it will be some local company. Again, this is going to be a very long process.

As for the debt level and the leverage, as I have said, our debt now stands at USD 2.7 bn. The comfortable leverage level is around 1x EBITDA, as we numerously stated. Our current cash flow is big enough to achieve this level pretty fast, so, probably, by 2020, we are going to deleverage down to 0. In that case, our majority shareholders are most likely to wish to get higher dividends. Because our capex is reducing, we do not see any attractive M&A targets in the marketplace. Most likely, in the horizon of one to three, four, or five years, our majority shareholders will wish to get big dividends, and we are going to act accordingly, because our cash flow is strong enough.

Boris Sinitsyn – VTB Capital

Just a small follow-up in terms of leverage. This 1x Debt / EBITDA level that you are referring to – is that gross debt or net debt?

Igor Kulichik (translated)

Gross debt.

Ksenia Mishankina – UBS

I have a couple of questions. Could you please indicate your capex guidance for FY 2016 and FY 2017? And do you plan to refinance any of your short-term debt? Thank you.

Igor Kulichik (translated)

We have not adjusted our capex plans for FY 2016 and FY 2017. For 2016, it stands at RUB 38.9 bn, and for 2017, it is about RUB 32 bn on a full-year basis. As for short-term repayments, we are considering some options, but it is too early to comment upon those. The cash we have on our accounts is enough to repay some bits of our short-term debt, but again, it is too premature to comment on it.

Des Kilalea – RBC Capital Markets

Coming back to the inventory: you said you had 16 mln carats in inventory, with a market value of about USD 1.5 bn. What is the minimum you would need for your working capital? I am just trying to identify how much is surplus inventory, or if it is mostly a working capital requirement at the moment.

Igor Kulichik (translated)

This number is well-known since we have disclosed it several times: that is 10–12 mln carats. This is technically the minimum level from the process viewpoint, because due to our processing and sorting technologies it is hard for us to go below that. The current level of 15 or 16 mln carats is 100% comfortable for us, there is no problem with it.

Beatrice Bushati – East Capital

I would like to ask you about the working capital. As you mentioned, there are some seasonal factors in this, but on the other hand, you sold many more carats than you actually produced. So I expected to see a working capital release. As a follow-up on that, what are your expectations for H2 2016? It seems like you will be producing more than you will actually sell.

Igor Kulichik (translated)

As I said, we expect no surprises in H2 2016, and no sharp fluctuations in demand, whether upwards or downwards. We expect the same thing with pricing. I think that prices and demand for H2 2016 are going

to be plannable; this does take into account the slowdown in July and August, and a recovery in demand in Q3 and Q4. Talking in inventory terms, I think the carat amount of inventories is going to remain flat by the year-end.

According to our plan, there may be a recovery in the inventory amount to the level of Q1 2016. But, upon the whole, we do not want to disclose premature numbers that are subject to risks and uncertainties and may differ from what we will actually have at the year-end. On the high level, we expect no dramatic surprises in demand and in prices during H2 2016. We shall bear in mind the strong sales of Q2 2016, so everything is going to be quite plannable and conservative.

Mikhail Priklonsky – Credit Suisse

I have just one question, on dividends. The Government has recently discussed the idea of taking interim dividends from several state-owned companies. ALROSA, however, was not on the list. Do you think there is any chance that ALROSA may pay interim dividend for 2016?

Igor Kulichik (translated)

We are not going to pay out any interim dividend, because we do not think that this makes much sense. The approval procedure would take too long and would most likely make the whole thing irrelevant. As to our dividend policy, currently it presupposes the payout ratio of at least 35% of IFRS net income, which means we may well pay more. This is something we have done this year, having paid 50% of our IFRS net income.

Denis Gabrielik – Otkritie Capital

I just wanted clarification on the previous question regarding your plan for the inventory. Am I right in saying that it is your base case scenario that your inventory will stay at the current level? Does that mean that in H2 2016 you will sell the entire production, or 20 mln carats, according to your plan?

Igor Kulichik (translated)

No, that is not quite correct. Our plans are actually to sell 37–38 mln carats on the FY basis, and before the year-end this number may become bigger. However, there is a possibility that the amount of our inventory will go up from the current level. But if it does, it is not going to be something material.

Denis Gabrielik – Otkritie Capital

One more question on the Q2 working capital. You saw a build-up in Q2 2016, what is the nature of that build-up in your working capital, which is roughly RUB 10 bn?

Igor Kulichik (translated)

There is a variety of drivers here. In Q1 and Q2 2016, our sales were very strong, and we sold a lot from our stocks. To remind you, at the end of 2015, we had 22 mln carats in inventories. Now we stand at 16 mln. Again, the end of Q2 and Q3 are traditionally weak, because we have a holiday season and a lot of planned maintenance and repair works. So, in Q3, production goes below what we have in the other three quarters of the year. Hence, in 2H the inventory may go somewhat up from the current level. There is clearly such a possibility.

Operator

That was the last question taken by our speakers today, and it does conclude our conference for today.