



**ALROSA**

ALROSA 2016 IFRS results  
conference call edited transcript  
16 March 2017

## ALROSA speakers

**Sergey Ivanov** – CEO

**Igor Kulichik** – Vice President – CFO

**Sergey Mezhokh** – Head of Corporate Finance

## Participants asking questions

**Sergey Donskoy** – Société Générale

**Dmitry Glushakov** – VTB Capital

**George Buzhenitsa** – Deutsche Bank

**Vahe Ovasapyan** – Goldman Sachs

**Barry Ehrlich** – Citi

**Nikolay Sosnovskiy** – Prosperity Capital Management

**Pierre Safa** – Silver River Capital

## Presentation

**Sergey Mezhokh**

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

Our top management team is represented today by Sergey Ivanov, CEO, Igor Kulichik, CFO, and Svetlana Linnik, Chief Accountant.

As always, before we start, I would like to quote the disclaimer. 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. We assume no obligation and do not intend to update such statements.

Now, I pass the floor to our CEO Sergey Ivanov. Please.

**Sergey Ivanov**

Good afternoon, ladies and gentlemen. I am happy to welcome you to our conference call on the Company's FY 2016 financial results. As I joined the Company a couple of days ago, I would like to highlight some things around our strategy. In 2013, our main shareholders approved the Company's strategy that proceeds from the following: first of all, focus on diamond mining and disposal of non-core assets; full replacement of recoverable reserves; improvement of operational efficiency through cost optimization, labor productivity gain and implementation of new technologies; higher diamond sales efficiency facilitated by quicker inventory turnover. In line with the strategy, ALROSA is looking to boost its diamond production organically up to about 40 mln carats by 2021 after reaching design capacity at the Udachny underground mine in the Republic of Sakha (Yakutia) and following development of kimberlite pipes at the Lomonosov Division in the Arkhangelsk Region of Russia.

ALROSA enjoys a strong financial performance and distributes dividends to its shareholders every year. Our dividend policy is to pay not less than 35% of net profit as dividends. The amount of dividends to be paid for 2016 will be defined in the nearest future. Implementation of the strategy will result in higher returns for ALROSA's shareholders, mostly driven by growth of dividend yield after capital investments into the above diamond mining projects have been completed.

As the new President of the Company, I would like to assure you that I am committed to the strategy and intend to make every effort to deliver it.

At this point, let me pass the floor to Mr Igor Kulichik, Vice President, CFO, who will present our financial results for FY 2016. After that, I would be happy to answer a couple of questions. Thank you.

**Igor Kulichik** (*translated*)

Good day, colleagues. I am sure you have had a chance to read through our accounts and press release for FY 2016. Hence, let me focus only on the key highlights of our financial performance and allow for more time for your questions.

2016 marked an active recovery of the diamond market after its slump back in 2015. ALROSA's revenue for FY 2016 reached RUB 317 bn, up 41% y-o-y in line with our product sales in physical volume terms. Please mark that in the course of the year, ALROSA's price index for diamonds did not change.

In the course of the year, the Company managed to sell 3 mln carats from its inventories. At present, ALROSA's inventories stand at 19 mln carats for the total amount of USD 1.8 bn. The mix is in line with our production.

In 2016, ALROSA managed to curb its operating costs growth to stand at 6% only, whereas the cost of sales went up by 39% in line with the sales volume.

The Company's net profit went up to RUB 133 bn, which includes the FX effect of RUB 73 bn. I would like to mark that dividends for 2016 will be calculated taking this non-cash item into account.

ALROSA's capex for the year stood at RUB 32 bn, which is less than the originally provided guidance of RUB 39 bn. This is explained by the fact that some of the works have been carried over into 2017. This includes the following investments: RUB 2 bn worth for the access road construction at the Verkhne-Munskoye deposit, RUB 1.7 bn worth for the technical overhaul and upgrade at our diamond production facilities, and RUB 2 bn worth for the compressor station at our gas assets.

ALROSA's free cash flow stood at RUB 111 bn and was mostly utilized for early repayment of our loans and borrowings. In the course of 2016, the Company's debt went down from USD 3 bn to USD 2.3 bn, whereas in Q1 2017, it was further reduced to USD 1.7 bn.

That concludes the presentation, and we are ready to take your questions now. Thank you.

## Questions and Answers

**Sergey Donskoy** – *Société Générale*

I have four questions.

The first one is on production and capex. Could you give us some numbers in terms of how much you are going to produce this year? Also, you have mentioned how much capex has been relocated from 2016 to 2017, but if you could give the number, that would be helpful.

The second question is, could you tell us what level of diamond inventories you currently hold and whether you have any plans to reduce the inventories further during this year or you feel comfortable and have no strong intention to do anything about them?

The third and fourth questions are about your development projects. Could you remind me how much it remains to invest in the development of the Udachny underground mine and the Verkhne-Munskoye deposit? Also, on the Zarya pipe, could you give me the number of the total capex for this project and the expected timeline when the project is supposed to be launched into production? Thank you.

**Igor Kulichik** (*translated*)

Let me start by answering your first question regarding our production plans for 2017. Our budget approved by the Supervisory Board of the Company stands at 39 mln carats on the production side and, before you ask it, it is the same on the sales side. That, in fact, answers your second question: we do not have any plans to increase or reduce the inventories. Again, please be reminded that the current inventories are 19 mln carats.

Regarding your questions pertaining to our development projects, as regards the Verkhne-Munskoye deposit, indeed, one project has been carried over from 2016 into 2017, and that is the construction of an access road of about RUB 7 bn worth. Please be reminded that RUB 7 bn are to be compensated to the Company from the Russian federal budget once the project has been completed. Regarding your last question on the Zarya pipe, we need some time to carve out the capex pertaining to this particular project from our total budget (it has no separate line for the Zarya pipe). We will revert in writing.

**Dmitry Glushakov** – *VTB Capital*

First of all, my congratulations to Sergey Ivanov on his new position. I do not have any questions regarding the results. The results are strong, and my congratulations on that as well. I have only one question with regard to the capital allocation strategy of the Company. Sergey mentioned in his presentation that the Company would continue to sell non-core assets and to be very conservative in terms of capex. Should investors expect larger dividend payments going forward? In the past several years, dividends were pretty low, and the company was spending profit to reduce debt. Now net debt to EBITDA is below 0.5x. We know that the policy is to pay not less than 35% of net income, the government wants companies to pay 50%, but actually the idea is that ALROSA can pay even more than this. What should we expect in regard to dividend strategy going forward?

**Sergey Ivanov** (*translated*)

Indeed, the results for FY 2016 were quite good. In terms of our dividend policy, I do not think that any change in the dividend policy could be envisaged at this point. The decision for 2016 still lies with the

Company's shareholders. I would like to reiterate our commitment to divesting from non-core assets, but any changes for 2017–2018 in that regard could be discussed at our next meeting.

**Dmitry Glushakov** – *VTB Capital (translated)*

Thank you. A follow-up question, please. Can we expect your presence at the Investor Day, which is upcoming?

**Sergey Ivanov** (translated)

Definitely, on remote connection. I will see and try to understand next week if I can physically show up.

**George Buzhenitsa** – *Deutsche Bank*

I have a few questions. First of all, on the disposal of non-core assets. Can you please provide an update on the disposal of the natural gas assets? With the arrival of the new CEO, could you please tell us whether this is more of a priority now than it used to be before?

My second question is, based on the production and sales guidance by your key competitors in the rough diamond market, is the new management team and the company still keen on the price-over-volume strategy, or could this change?

**Sergey Ivanov** (translated)

Thank you for the question. As for the natural gas assets, that issue is going to stay in my focus. Yesterday I met with the management teams of these assets and we had an extensive discussion in that regard. The company is definitely looking to maximize the price when divesting from that asset, and we will maintain the issue in our regular focus, we will be in continuous discussions to achieve that. Regarding the price-over-volume strategy, let me pass the floor to Mr Igor Kulichik.

**Igor Kulichik** (translated)

Indeed, last year the Company pursued the price-over-volume strategy, and we are going to maintain it in 2017. With the responsible approach to volumes offered to the market, whereas at the same time trying to maximize the price, we manage to keep the market stable. De Beers is pursuing the same strategy without according that with us, and this serves to prove that our strategy is right. On top of that, not only did we manage to maintain the market stable in 2016, we also managed to carry this into Q1 2017. We are going to present our results for Q1 rather soon, and you will see how successful they are. The market has been stable, the price fluctuations are insignificant, and the volume is priced in by the market as well.

**Vahe Ovasapyan** – *Goldman Sachs*

Thank you for the presentation. Sergey, thank you for attending the conference call. I have a few questions. The first question concerns your polishing division and strategy. Do you consider any expansion of the polishing division, and, on this front, are you interested in Kristall privatization at any price?

The second question, I believe it might be too early to ask, but do you consider creating an artificial diamond division, like the one that De Beers has right now?

My last question is about ALROSA's exploration assets in Africa. In your view, is it better right now to invest into some Russian exploration assets and expand production in Russia, or do you consider some investments in Africa?

**Sergey Ivanov** *(translated)*

Regarding our polishing business, and let me use cautious wording here, at present we do not have any plans to expand our current polishing business. Instead, we will need to look into the polishing business as it currently is to understand the economics of it.

Regarding your second question, the subject of artificial diamonds is at least worth monitoring in the market. As far as I hear from my predecessor and other colleagues, at present, ALROSA does not have any plans to establish any division to foster artificial diamonds in-house.

Regarding your third question, and I will also use careful wording, we are going to carry on with our exploration assets in Russia, although, indeed, we have some volumes of exploration efforts in Africa as well. We will carry on with this exercise and we will see how to follow through with it based on our strategy.

**Barry Ehrlich** – *Citi*

I have two questions for Mr Ivanov, if I may. What objectives were laid out for you by the Board to improve or do differently when you were offered the position?

And secondly, is it possible that you would consider expanding the Company's mining operations into other products outside of diamonds?

**Sergey Ivanov** *(translated)*

Among the objectives set out by the Supervisory Board are, obviously, improving operating efficiency and transparency for the shareholders, upgrading and modernizing our production assets, and sustainably delivering on our strategy.

As for the second question on other market segments, we are currently focused on our core business, which is diamond production, and at present, I can hardly see an opportunity to start looking towards other production areas.

**Nikolay Sosnovskiy** – *Prosperity Capital Management*

I have a few follow-ups. The first is to the new CEO. We have touched on the African assets, the exploration matters there, but what about the existing assets? What are your views on Catoca? Would you consider increasing your stake in Catoca Mining up to 50% and consolidating the asset, and potentially buying more licenses in Africa, such as Luaxe?

The second question is to Mr Igor Kulichik. Can you please specify the total capex for 2017? You have mentioned the carry-overs from 2016 into the next year, but I do not think the total number has been mentioned.

And the question on the market, on the current developments. I think throughout the majority of H2 2016 and early 2017 polished diamond prices were declining, while rough diamond prices remained virtually flat, which means depressed margins in cutting and polishing. What is your view on the current profitability of these operations and potential need to resolve this low profitability matter if it is in fact low?

**Sergey Ivanov** *(translated)*

Regarding the first question on Catoca, I have recently looked into this asset and its financial performance. At present, the Company does not have any plans to consolidate the asset or increase its stake in the

asset. I understand that from time to time the market has propositions to buy or sell some stakes. In case we receive an offer to buy a stake, we will consider it, and then, based on its feasibility, potential returns, payback and profitability, we will make our informed decision. As for Luaxe, I think we will look into it going forward, but it is not on the agenda at this time.

**Igor Kulichik** *(translated)*

Regarding our capex for 2017, the budget of ALROSA approved by the Supervisory Board provides for a capex number of RUB 36.5 bn.

Regarding the question on the market, indeed, we have seen some reduction in the cut and polished product prices in 2016. At the same time, look at rough diamond prices in 2015–2016. Both ALROSA's and De Beers' prices went down by a total of 15%, which is exactly the tool that allowed to clear through any bottlenecks in the diamond pipeline, thus enabling good margins and profitability for both sightholders as well as cutters and polishers.

**Pierre Safa** – *Silver River Capital*

I just wanted to clarify. You have mentioned RUB 7 bn that you will be spending in capex for the construction of an access road at the Verkhne-Munskoye deposit, which will later be reimbursed by the local government. Is that included in the RUB 36.5 bn you have mentioned?

The second question is, what cost reduction initiatives, if any, will you be targeting in 2017? Does that form a part of your agenda or not?

**Igor Kulichik** *(translated)*

Regarding the first question, the RUB 7 bn compensation from the federal budget is due once the mine has been completed and becomes operational. That means the compensation will be received from the budget not in 2017 or 2018, but beyond that, it is more into the distant future. So the number of RUB 36.5 bn is the total capex number and we will not get the RUB 7 bn compensation in the course of 2017.

As for the second question on the cost reduction initiatives, the Company runs several programs to that effect. One of them includes energy efficiency, fuel saving, etc. It was adopted by the Supervisory Board and has been in effect for several years. Another program is aimed at innovation development, which also has a cost-cutting element within it. ALROSA has a multitude of cost optimization tools rather than a single cost cutting plan.

**Sergey Mezhokh** *(translated)*

Dear colleagues, since there are no further questions, we thank you for your time, and we will see you on the Investor Day.