ALROSA Q2 and H1 2017 IFRS results conference call edited transcript
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ALROSA speakers

Sergey Ivanov – Chief Executive Officer
Igor Sobolev – First Vice President – Chief Operating Officer
Alexey Philippovskiy – Chief Financial Officer
Yuri Okoyomov – Vice President for Sales
Svetlana Linnik – Chief Accountant
Sergey Mezhokh – Head of Corporate Finance

Participants asking questions

Vahe Ovasapyan – Goldman Sachs
Dan Shaw – Morgan Stanley
George Buzhenitsa – Deutsche Bank
Anton Fedotov – Bank of America Merrill Lynch
Dominic O’Kane – J.P. Morgan
Paul Ballantyne – Genesis
Barry Ehrlich – Citi
Nikolay Sosnovskiy – Prosperity Capital Management
Evgenia Molotova – Verno Capital
Boris Sinitsyn – VTB Capital
Sergey Donskoy – Société Générale

Presentation

Sergey Mezhokh

Good day, welcome to ALROSA’s conference call on 6m 2017 results. I will make a few introductory notes.

Our team today is led by Sergey Ivanov, CEO, together with the top management.

Before we start, I would like to quote the disclaimer. 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 to be 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 Sergey Ivanov, please.
Sergey Ivanov

Good day, colleagues. I am happy to welcome you to the Company’s H1 2017 results conference call.

Before discussing our financial performance, I would like to make a few statements to update you on the situation at the Mir underground mine and the changes in the Company’s plans following the accident.

On 4 August 2017, the Mir underground mine was flooded with water from the pipe of the depleted open-pit mine, trapping 151 miners underground. Thanks to concerted efforts, 143 miners have been rescued. The rescue operation at the Mir mine lasted three weeks. The search was going on 24/7 in three shifts at a depth of 550 and 600 meters with water constantly flowing in. The extracted rock mass amounted to 19,000 m³ and over 1.2 kilometers of mine workings were cleared. The operation involved over 30 pieces of machinery, aircraft, divers and industrial climbers. On 25 August, the Emergency Response Centre adopted a resolution to stop the rescue operation, as the water volume accumulated in the open pit mine was over 33,000 cubic meters and the stability margin factor of the lower pit bench exceeded its threshold values. With a heavy heart, we must admit: no hope was left that we could find the eight miners alive and bring them to the surface. We would like to express our sincere condolences to the miners’ families, with the relevant support and financial aid to be provided.

The reasons and circumstances behind the accident will be stated following an investigation by the Rostechnadzor’s special committee. Based on the investigation findings, we will take measures ranging from our personnel to technologies to avoid such accidents in the future. Guilty persons, if they are found, will be punished in accordance with the Russian law. The Company’s management renders full assistance to the regulatory and law enforcement agencies.

In addition, ALROSA commenced a comprehensive safety assessment for mining operations at all of the Company’s underground mines. A panel of experts will assess the potential impact of water bodies on the mine workings and the measures taken to prevent water breakthroughs from the depleted open pits into such workings. Should any faults be identified, measures will be taken to eliminate them promptly. Also, to investigate the Mir mine disaster profile, the Company engaged international experts from SRK Consulting and DMT Group. These are experts involved at the initiative of the team of four independent directors on the Supervisory Board of our Company. Hence, we expect to see the most unbiased assessment of the accident’s causes.

Given the circumstances, it is too early to talk about any timing or costs of recovering the Mir underground mine. It is obvious that before the causes have been determined and the mine recovery measures developed, no production will take place at this mine.

The mine property has a full all-risks insurance coverage based on the replacement cost and is provided by SOGAZ. Both the Company’s functions in charge and SOGAZ’s experts have already got down to assessing damage as prescribed, with an exact amount of compensation to be determined based on the outcome. We do not expect any delays from SOGAZ. If I may reiterate, SOGAZ is the leader in the Russian industrial insurance market and enjoys reliable reinsurance protection, including extended reinsurance coverage of underground risks.

As regards the accident’s impact on the Company’s production plans, it stands to state the following. ALROSA’s 2017 budget provides for the production of 39.2 mln carats, including 3.3 mln carats at the Mir underground mine. Due to the incident, the Mir mine will only produce 2.7 mln carats in 2017, with the missing volumes to be set off by higher output at other production facilities of the Company, primarily
Aikhal’s Jubilee pipe. This will allow us to achieve the previously announced diamond production target of 39.2 mln carats in 2017.

We do not expect any significant changes in the Company’s 2017 sales plans. We project the sales of rough diamonds in 2017 to be on par with the production volume, as the existing inventories of 14.4 mln carats are enough to deliver on our 2017 plans. The time lag between production and sale of diamonds can reach up to six months. Hence, the suspension of production operations at the Mir underground mine will not have any material impact on the Company’s plans until 2018. Furthermore, the average price of diamonds produced at the Jubilee pipe (USD 138 per carat) is comparable to that of stones coming from the Mir pipe (USD 127 per carat). This will help minimize the impact that the increase in production at the Jubilee pipe will have on the average selling price of the Company’s diamonds.

The Jubilee pipe’s production costs per carat are lower than those at the Mir mine. The need to deal with some of the semi-fixed costs at the Mir underground mine, though, is likely to affect the Company’s margins.

While diamond production is currently suspended at the Mir underground mine, the Company pays all the salaries due to the employees deployed at the production sites and 2/3 of the salaries due to the mine’s administrative and management staff. Our Company is working on a plan to relocate the mine’s production staff to Udachny and Aikhal Divisions with a view to streamlining the Company’s operations under the current circumstances.

We are drawing up a budget for 2018 and making medium-term development plans. After they are reviewed and approved by the Supervisory Board in December 2017, we will announce our key medium-term expectations. The latter will include projections on how lower production could affect our financial performance, with available internal reserves and macroeconomic indicators taken into account.

Turning to our financials, I would like to say a few words about changes in our executive team. Since 28 August, we have a new CFO – Alexey Philippovskiy. Alexey has a vast professional experience in Russian and international companies. He will be in charge of all financial functions in the Company: planning, budgeting, corporate finance, investments and investor relations. Earlier, these duties used to be distributed between two vice presidents. Today, Alexey is on the call and is ready to introduce himself. I will pass the word to him a little bit later, after I finish the presentation.

The Company’s financial results were disclosed yesterday, and I am sure you have had enough time to take a look at them, so I will simply name the key drivers behind them.

In H1 2017, the Company’s performance was under pressure due to ruble appreciation (up approximately 18% vs H1 2016) and diamond sales mix as another adverse factor. I would like to remind you that by the end of 2016, the Company had accumulated inventories of small-size rough diamonds that had not been purchased because of the monetary reform in India. These inventories were cleared in H1 2017, causing a 15% drop in the average price of the diamonds sold. Because of these two factors, which were beyond the Company’s control, revenue for H1 2017 declined by 17%, EBITDA by 35% and net profit by 46% vs H1 2016.

Also, I would like to note that the adverse impact of stronger ruble and the changed sales mix was partially offset by a 12% growth in volumes of diamond sales. Diamond inventories stand at 14.4 mln carats, dropping by more than 5 mln carats year-to-date.
In Q2 2017, the volumes and sales mix stabilized, with a total of 10.2 mln carats sold, which is in line with production volumes. The average price of diamonds sold increased by 20% vs Q1 2017, triggering a rise in EBITDA margin to 53% in Q2 2017.

The cost of goods sold increased by 12% in H1 2017, driven solely by higher sales volumes. Production costs grew by less than 1% in H1 2017 despite the 14% increase in diamond production volumes in the same period.

Talking about cost management in general, it stands to note that the Company has a long-term cost optimization program in place embracing over 150 initiatives designed to cut costs and improve performance across the key production stages. The impact of the OPEX reduction initiatives is expected to amount to around RUB 800 mln in 2017 and over RUB 2 bn in 2018 thanks to switching to cheaper energy sources, capping the utilization of materials and equipment, and streamlining the Company’s organizational structure. I would like to mention separately that for 2018 budgeting purposes, our business unit managers are required to make sure that 2018 costs do not exceed the 2017 level provided that production targets are met and the equipment maintenance quality and safety profile are not compromised.

In H1 2017, CAPEX decreased by 22% largely due to our cost reduction efforts. FY 2017 CAPEX is expected to stand at RUB 31.6 bn, which is RUB 5 bn below the previously announced guidance of RUB 36.5 bn. The reduction is driven by the optimization of costs thanks to improved procurement procedures and modified projects.

The Company’s free cash flow for H1 2017 exceeded RUB 50 bn and its liquidity position remains strong, with the net debt to EBITDA ratio hitting an all-time low of 0.3x. The Company’s liquidity position was confirmed by the recent credit rating upgrade by S&P to match the sovereign rating.

This concludes my presentation, and we are now ready to take your questions. Before we start, I will ask Alexey Philippovskiy to briefly comment on his background.

Alexey Philippovskiy

Thank you. It is a pleasure to be here. I would like to use this opportunity to briefly introduce myself. I come from Yekaterinburg, for those who do not know, it is a large industrial city in the very middle of Russia. I received my education in the USA: I hold an MBA from UCLA and a master’s degree in public administration from the Maxwell School of Citizenship and Public Affairs in New York. I have been in finance my entire professional life, which is over 20 years. My career started back in 1995 in the USA, where I worked as an accountant for a media company, which is now part of the Liberty Media group. After that, I joined a Russian-American joint venture called Mobile Telecom, in Moscow, first as financial controller and later becoming CFO. Then I got my MBA and joined McKinsey & Company, where I specialized in finance and participated in projects for many large Russian companies. In 2004, while still at McKinsey, I started a strategy project for SIBUR, Russia’s largest petrochemical company. Upon completion of that project, I was asked by SIBUR’s CEO to join his team, which I am glad I did. Altogether, I was with SIBUR for over nine years, almost seven of them as CFO. In that role, I had a lot of interactions with the international financial community. We contemplated an IPO, tried to complete a management buy-out, did several large syndicated loans and complex project finance deals for the Tobolsk and RusVinyl projects. Just before my departure from SIBUR, I led the first placement of SIBUR’s Eurobonds. Immediately before joining ALROSA, I worked for Andrey Melnichenko as CFO of his energy business – Siberian Generating Company. I am excited about joining ALROSA and look forward to working with you. Thank you.
Questions and Answers

Vahe Ovasapyan – Goldman Sachs

My condolences on this tragic accident. I have a few questions regarding the Mir mine accident and its potential impact on the financials. The first one is about potential restoration of the Mir underground mine. I fully understand that it is too early to say what time would be needed to resume production, but given that we have heard some rumors from local Yakutian newspapers that potential resumption will take several years, could you provide any comments? Will it take several months or several years to restore production at the Mir underground mine?

Igor Sobolev (translated)

As you heard in the statement by Alrosa’s CEO just now, in the current circumstances it is too early to talk about the timing or cost of potential recovery of the mine. However, it is already apparent that this is going to be a tough exercise taking more than just a few months. We are looking into solutions now and it does seem rather challenging.

Vahe Ovasapyan – Goldman Sachs

My second question is about other underground mines. I would like to know your opinion on the Udachny underground mine, which, to the best of my understanding, faced similar issues with water coming into the mine in the past. Could you see any potential difficulties leading to drop in production or, perhaps, some temporary stoppages to fix any issues with water coming into the mine at your Udachny project?

Igor Sobolev (translated)

I can assure you that no other mine has been or is operating under similar conditions as compared to the Mir underground mine. If you take the Aikhal or the International underground mines, they only collect atmospheric water and there is no water flood coming into the open-pit. If you take the Udachny underground mine in particular, there is no cushion of solid rock between the open-pit and the underground mine, so there is no build-up of huge volumes of water at the Udachny open-pit mine in a similar fashion as was the case with Mir. A panel of experts has looked into technological solutions used in other underground mines in view of the recent accident at Mir, and we can assure you that the outcome and conclusion of their work indicated that no similar accidents are possible at the other underground operations.

Vahe Ovasapyan – Goldman Sachs

I have two more questions. The next one is more about financials and accounting, but it is quite important, given that you pay your dividends as a percentage of net income. Given the accident at the Mir underground mine, are you planning to recognize the asset impairment?

Svetlana Linnik (translated)

No impairment is currently being considered. As you have heard from earlier statement by Igor Sobolev, Chief Operating Officer, currently a panel of experts is looking into the damage incurred by the underground mine and the impairment will be considered once their work is done.
Vahe Ovasapyan – Goldman Sachs

My last question now. I fully understand that we are only half-way into 2017 and it is too early to comment upon that, but given that the Mir underground mine is likely to be closed for the whole 2018 and that this year the mine produced around 2 mln carats, is it possible that the production in 2018 will be lower than in 2017?

Sergey Ivanov (translated)

I cannot exclude that the probability is relatively high for the ALROSA Group total production number in 2018 to be insignificantly lower than the number in 2017. However, if you consider sales rather than production, we do not expect any major deviation here.

Dan Shaw – Morgan Stanley

My first question is about the Mir insurance policy you mentioned. Can you give a bit more details on what it covers you for? Does it cover you for the remediation costs, loss of revenue, fixed costs of paying the salaries to those workers you mentioned (that are still for the most part being paid)? Can you give a little more information on that, please?

Sergey Ivanov (translated)

The insurance certificate is not currently in front of me, but I was the CEO of SOGAZ at the time the certificate was signed. As far as I recollect, it covers all the risks of underground mining operations. Certain limits do apply, with the overall limit exceeding RUB 10 bn and sublimits applying to particular types of operations such as the mine recovery. In a nutshell, we will get compensated for the recovery costs. However, Russian insurance companies traditionally do not insure against business interruption or suspended production, so these are not going to be compensated.

George Buzhenitsa – Deutsche Bank

I have two questions. First of all, on the accounting of the accident at the Mir mine. Is there going to be an impairment charge in your financial statements? Will it have any impact on the dividends for 2017? Also, what is the timing for coverage payments from SOGAZ and how will you reflect them in the financial statements? Will you recognize that coverage as operating or non-operating income? And the second question is about the production increase at the Jubilee and Aikhal mines which should – at least, this year – offset the production decrease resulting from the Mir accident. I assume it is quite feasible in the short run. But do you think you can sustainably increase production at those assets beyond 2017? And if so, can you please give us any guidance in respect of the CAPEX associated with that production increase? Basically, the question is how much is it going to cost you.

Svetlana Linnik (translated)

The Mir fixed assets impairment will indeed have an impact on their book value should the decision be made for them to be impaired. That is going to happen following the investigation by a panel of experts, as you heard previously. Once the SOGAZ money comes in, it would be recognized as a part of non-operating income, although I cannot tell you at this point which particular period that compensation will fall into.
Igor Sobolev (translated)

Indeed, we are planning to partially offset the Mir production volumes with the volumes coming from other existing operations such as the Jubilee and International pipes and also alluvial deposits. This is not going to require any large-scale capital investment. We are only going to need small amounts to procure mining equipment, and that is it. No major investment in capital construction is expected.

Anton Fedotov – Bank of America Merrill Lynch

I have two questions. First, can you please clarify the sales guidance for the FY 2017. Earlier you mentioned that the sales would be on par with production, but you sold some inventories in Q1 2017. What is the total sales guidance in terms of millions of carats? And my second question is about dividends: if you incur an impairment for the FY 2017, will you adjust for it when calculating the dividends for the year?

Yuri Okoyomov (translated)

We can confirm what we said earlier: our sales in the FY 2017 are going to be at least on par with our production. That is the word – at least. We must take into account the seasonality factor as well. For a number of years in a row, the second half of the year has produced somewhat weaker results on the sales side as compared to the first one. This does not reflect the production patterns at all but rather reflects the demand for rough diamonds. The Company is going to reconfirm now its guidance as stated previously: our sales in carat terms are going to be at least on par with production volumes.

Svetlana Linnik (translated)

The dividend decisions are made by the Supervisory Board. And if it decides to go for the adjustment, we will disclose that information immediately.

Dominic O’Kane – J.P. Morgan

I have three questions. First, you are preparing the 2018 budget, and I understand your comment about the absence of Mir-like technical risks at other mines. But has the Mir accident forced you to reappraise the technical risks throughout your portfolio? Have you identified other technical risks at your other operations that may have an impact on the 2018 and longer-term production guidance?

Second, now that Mr. Ivanov has been on board for nearly six months, I wonder if you could give some clarity on how the ALROSA strategy will change, if at all. The evolution of the balance sheet, which is on its way to reach the net positive cash status in the next couple of years, is of special interest here.

And finally, as we exit August, which is likely to be the slowest month for the rough diamond demand, I would like to ask if you could give us an update on what you see in the market taken more broadly. Are you confident in all of the demand over the next few months heading into the Christmas period?

Igor Sobolev (translated)

I would like to reiterate that the expert panel has looked into all the other underground operations of the Company and concluded that there is no additional technical or technological risk involved that could lead to or force any changes in our extraction technology or require a major capital investment. Let me repeat this: the Mir underground mine is unique because there is a powerful water flow of 1,200 m³/h going into the open pit located just above the underground mine. Our other underground mines do have open pits above them but these collect only the atmospheric water. And the Udachny underground mine in particular
does not have the problem at all because there is no rock body between the open-pit and the underground mine, so no reoccurrence is expected.

**Sergey Mezhokh (translated)**

There is no desire on the part of the Company to reduce its debt burden to zero. Our liquidity is currently quite good, which has been further reconfirmed by a rating hike by the Standard & Poor’s credit rating agency. Our comfortable level is 1.0x EBITDA, and our current net debt to EBITDA ratio is even further below that. We follow a balanced approach to our financial policies, and the Company intends to be present in public debt markets. We are going to pursue that policy looking forward.

**Yuri Okoyomov (translated)**

Regarding the feel of the market, if you look back 18 months (FY 2016 and 2017 year-to-date), there has been a strong demand for rough diamonds indeed, as proven by our sales figures and the overall pricing dynamics. H2 2017 will be affected by a number of drivers that are not always easy to calculate through. However, we can see the demand recovering in China, which is a major off-taker in terms of diamond jewelry. Major retailers, such as Chow Tai Fook and Chow Sang Sang, have reported their H1 2017 results with a strong boost to their sales. September is going to see the Hong Kong Fair, where we expect some good results to come. H2 2017 is going to be special this year in terms of the Diwali festive celebration in India happening one month earlier than usual. Cutters and polishers in that particular country suspend operations and let their employees go for the festive season. Because of that, we do not expect any strong demand for rough diamonds in September and October. However, should the Hong Kong Fair produce some good results and retailers in the United States need to do some restocking in view of the Christmas holiday season, the demand is going to get back to normal levels in November and December.

**Paul Ballantyne – Genesis**

Regarding your reduction in the CAPEX estimate for this year, could you explain where it comes from? Mr Ivanov has made a brief comment, but a little more detail would be interesting. Can we expect the whole of your CAPEX profile going forward to step down by that amount or is this a one-off shift?

**Sergey Mezhokh (translated)**

CEO has mentioned during his presentation that FY 2017 CAPEX is going to be RUB 5 bn or so lower than the earlier guidance we produced. Out of these RUB 5 bn, RUB 2 bn is contributed by the optimized procurement procedures and other internal efficiencies, whereas the remaining RUB 3 bn is effectively a carry-over of our capital investment plans into the following period.

**Barry Ehrlich – Citi**

I have three questions. At the Jubilee pipe, what mining tonnage is possible and how quickly can you get to that level? Which processing plant outside of the Mirny complex has underutilized processing capacity and how much? Is it economical to ship from the Jubilee pipe or other mines outside of the Mirny Division to the Mirny processing plant, and what is the approximate shipping cost per ton?

**Igor Sobolev (translated)**

Regarding your first question on the Jubilee pipe capacity, we are going to mine 7 mln tons of ore per annum. As we have mentioned earlier, no large-scale CAPEX is required to achieve that number. The total production volume is going to depend on the geological situation at the mine and the optimal
Nikolay Sosnovskiy – Prosperity Capital Management

Can you dwell a bit more on the Mir situation? What exactly did you discover during the rescue operations? What are the areas damaged, what damaged equipment and parts of the mine have you identified already? What is needed in terms of current support in order not to lose control over the situation and to contract the current inflow to prevent any further damage of the mine? Do you have any current cost estimates on such support?

Igor Sobolev (translated)

We are not ready to provide such high degree of granularity at this point in time. The rescue operation has just been completed, and there is water flood in mining workings. We decided not to pump the water out, because the rock body has a lot of salt in it, and pumping will remove the salt, hence reducing the stability of the housing rock. We decided to preserve the mine by keeping the water flood. In the future, once the recovery is underway, we are going to extract the water and renovate the mining workings. As to the timing and cost of such operations, it would be too early to consider them at this point.

Nikolay Sosnovskiy – Prosperity Capital Management

My second question is on the market. Recently, we have had some news that two big Indian diamantaires have gone bankrupt (one in Belgium, one somewhere else, I think). Do you expect any impact on the market and do you see any strategical instability, which led to such dire consequences? Can it affect your sales policies or your relations with other diamantaires and sightholders?

Yuri Okoyomov (translated)

We have the information you are referring to. Unfortunately, there is no clarity about the causes behind those bankruptcies or their scale. This cannot affect the market in general, but adds to the nervous situation in the market. We are monitoring the situation, although we do not expect any major impact on the demand for both rough and polished diamonds looking forward, up until the year-end at least.

Evgenia Molotova – Verno Capital

I have two questions. With absence of the Mir underground mine and it’s replacement by the Jubilee pipe, how will it affect the average grade for the Company in general? Is there any state-level investigation of the accident, which can potentially cause fines, similar to what happened to Uralkali before, although in a different situation?

Igor Sobolev (translated)

Regarding your question on the average grade of ore, it is not quite correct to compare ore grades from open-pit operations and underground mining operations. I can assure you that the price per carat from the Mir underground mine and the Jubilee pipe is pretty much comparable. It is even slightly higher at the arrangement of the mining levels. Answering your second question, processing plant No. 14 located at the Jubilee pipe does have some spare capacity. Processing plant No. 12 at the Udachny Division is currently under major overhaul. By 2019, we expect its total capacity to reach 10.5 mln tons of ore. Regarding your third question, processing plant No. 3 of the Mirny Division is not going to be used to process ore from other mines, it is merely impractical due to the distances involved: other mining divisions are located more than 500 kilometers away from there. However, we are going to ramp-up production from our alluvial deposits, and process the sand from there at processing plant No. 3.
Jubilee pipe, whereas the cost of production is several times lower. Regarding your second question about the investigation, the accident is currently investigated by a dedicated commission set up by Rostechnadzor, the Russian government agency in charge of technical and technological supervision. The commission is led by the Head of Underground Mining Supervision at Rostechnadzor. The Investigative Committee of the Russian Federation is also involved. The commission is going to identify the causes behind this accident and guilty individuals, should there have been such. No fines for the Company are envisaged.

Evgenia Molotova – Verno Capital

One more clarifying question. You have said that it will be partially offset by Jubilee, International and alluvials. Can you give the exact percentage? How much is “partially”?

Igor Sobolev (translated)

It is too early to discuss the particular breakdown of this replacement. We are working to adjust our plans now. When I said “partially”, I meant to say the following. It is currently evident that over 3 mln carats of the Mir’s underground mine production are impossible to replace in full at the expense of other mining operations at ALROSA. But, as CEO, Sergey Ivanov, has mentioned, the Company is going to strive to minimize this impact.

Boris Sinitsyn – VTB Capital (translated)

First of all, my condolences in relation to the accident at the Mir underground mine. Also, my best wishes to Alexey Philippovskiy in his new position. My first question relates to your sales plan for FY 2018. I did hear a statement by Sergey Ivanov earlier today, but the connection was faulty, so I wanted to reconfirm this. If I am not mistaken, even though your production volume may go down for FY 2018, your sales target for that year is not going to be affected. Is that the correct understanding? If so, what is your minimal level of inventories (in carats)? How far can you go down on your inventories, if you have to sustain sales above production for a certain time period? My other question concerns your insurance. What are the limits and sublimits? Would they suffice to compensate for the costs incurred while recovering the mine? My third question relates to the book value of the Mir underground mine. How much is that? Another question is about the fixed costs that the Company still has to fund the salaries and wages of both mining employees and administrative personnel at Mir. How much would that amount to for one full year?

Svetlana Linnik (translated)

As we explained earlier, it is difficult to assess today the compensation and the costs incurred or to be incurred for recovery of the mine. Hence, we cannot comment on either the insurance or the book value of Mir assets and the fixed costs that we are running to compensate for salaries and wages. We would revert to you with an answer later.

Sergey Donskoy – Société Générale

I have three questions. First, is there a risk that the Mir underground mine will permanently remain out of use and it would be economically impossible to prevent further flooding? When do you think you will have some certainty to this regard? The second question is about the Jubilee mine and its ability to partially compensate for the volumes lost at Mir. You mentioned that Jubilee is going to operate at the rate of 7 mln tons of ore per annum. If I am not mistaken, in the past (at least during the last two years), the annual volume of ore processed at the Jubilee mine was in excess of 8 mln tons of ore. Could you somehow
reconcile these numbers? Lastly, a question on your market assessment. You mentioned that you see the rough diamond market recovering, in particular in China. Can you somehow reconcile these trends with the declining prices for polished diamonds, which remain in the downtrend this year and have declined again substantially since the beginning of the year?

Igor Sobolev (translated)

As I mentioned previously, it is a technologically challenging task in terms of recovering the Mir underground mine, so we cannot answer this question at this point in time. Regarding your second question, the Jubilee pipe did process more ore, but that ore was effectively off-balance ore coming from ore storage facilities. Now we are going to increase the processing volumes of higher grade ore, which is about changing the feeding mix at our processing plants. The level of production of high grade ore purely depends on the mining environment and planning in terms of developing the Jubilee pipe.

Yuri Okoyomov (translated)

Indeed, there is diverse dynamics of the pricing environment between polished products and rough diamonds. It is not the first time that the two trends diverge. Even though there is a high demand for rough diamonds, price indices for polished diamonds demonstrate a certain decline. It is not the first time in the history of this market that the cycles have overlapped counterphase-like. In H1 2017, the polished demand was definitely affected by the FY 2016 sales results as disclosed by major public retailers. I am referring to Tiffany and Signet in particular, who did demonstrate some decline in their sales, which could not but exercise certain pressure on the market. However, looking into the end of Q2, they did demonstrate a certain growth in their sales figures y-o-y, which is a positive signal. China does see an improvement, especially visible after two years of declining demand. Overall, H2 2017 has many factors coming into play, as I mentioned while answering one of the previous questions. Those factors are impossible to calculate through in full. However, the currently disclosed public data give us reasons to believe that the situation is going to improve by the year-end.

Sergey Donskoy – Société Générale

I have a follow-up question regarding the Jubilee mine. If I am not mistaken, according to the mining plan that was disclosed as part of the reserves statement, you expected grades at the Jubilee pipe to begin to decline starting from next year and to drop by about 30% over the course of the next 3–4 years. Is this indeed something you expect to see or was that an overly cautious assessment by your mining consultants?

Igor Sobolev (translated)

Indeed, we are going to see some decline in the volume terms of Jubilee production, but such huge reduction in the ore grade (as much as 30% as you mentioned in your question) is definitely not going to happen. The thing is that Jubilee effectively has three sections of ore body. The grade of ore is different across the three different sections. The overall resulting average grade depends on how much you produce from each particular section.