Good day, welcome to ALROSA’s conference call on 2017 results. I will make a few introductory notes. Our team today is led by CEO Sergey Ivanov 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 materialise 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.

Good day, ladies and gentlemen. Dear colleagues, I am happy to welcome you to our full-year 2017 results conference call. Today, we will highlight key factors behind ALROSA’s 2017 results, and I will be ready to answer your questions.
In 2017, the performance of key diamond jewellery markets was positive. We estimate that the diamond jewellery market grew by 5%. Thanks to increasing diamond jewellery sales and diamond prices, the sentiment in the rough diamond market is also positive. Let me remind you that the rough diamond resource base is finite. We estimate that the global diamond mining reached its peak in 2017 – which is good news for future rough diamond prices. Our full-year 2017 financial results were under pressure from a mix of both external and internal factors. Due to increased demand for small-size rough diamonds in early 2017, the average selling price of gem-quality diamonds dropped by 9% in 2017, which together with a 13% rouble appreciation was the key reason dragging down our annual performance.

Obviously, the Mir accident was the worst event of the year. We lost eight miners, which is the heaviest part of this tragedy for the Company. The accident forced us to incur additional expenses and lower our mid-term production guidance. We have completed measures to re-employ the Mir mine workers, and are close to being fully compensated by the insurer for losses from the partial write-off of the mine’s fixed assets.

With no diamond production at Mir, expanding presence in Angola has also become our strategic priority. In 2017, we made an upfront payment for a further 8.2% stake in Catoca Mining, effectively increasing our shareholding to 41% and ensuring a stronger role in the development of the Luaxe pipe in close proximity to Catoca’s infrastructure.

I would also like to mention a 2018 event that is of strategic importance to our development. As you may know, on 19 February 2018, ALROSA disposed of its gas assets in an auction that raised RUB30.3 bn. This step is a serious testament to our continued strategic focus on diamond production and non-core assets disposal.

At this stage, let me pass the floor to Alexey Filippovskiy, our Chief Financial Officer. Alexey will walk you through the Company’s financial results. Thank you.

Alexey Philippovskiy

Good afternoon and good morning. 2017 became one of the most successful years for us in terms of production and sales of rough diamonds. The Group produced almost 40 mln carats and sold over 41 mln carats of diamonds. Last time a similar diamond output was recorded back in 1990. The Company’s financial performance in 2017 was under pressure from the 13% Russian rouble appreciation. This factor alone brought our EBITDA down by over RUB 37 bn. A change in the diamond sales mix was another influential factor. By the end of 2016, the Company had accumulated inventories of small-size rough diamonds that had not been purchased because of the currency reform in India. These inventories were cleared in 2017, causing a 9% drop in the average price of the gem-quality diamonds sold. This factor brought our EBITDA further down by RUB 27 bn.

On the back of volatile market demand in 2017, the Company made efforts to increase sales and optimise costs. We produced 39.6 mln carats of diamonds, up 6% against 2016, and sold 41.2 mln carats, using inventories to cover for the difference between the production and sales volumes. Our diamond inventories decreased by almost 2 mln carats down to 18.2 mln carats as at the year end. As for cost optimisation efforts, the Company runs a programme comprising initiatives to increase operational efficiency, such as switching to cheaper energy sources, improving vehicle and other equipment utilisation, etc. Total costs went up by 6%, largely on the back of an 8% increase in extracted rock mass, 6% growth in diamond output and 3% increase in sales volumes. Costs were also pushed up by a series of one-off, non-production related events, such as accident recovery operations at the Mir mine, higher contribution to the Diamond Producers Association, and the absence of one-off gains from inventory revaluation that took place in 2016. Adjusted
for these items, our production costs per carat and extraction costs per m\(^3\) of rock mass actually slightly decreased vs the 2016 level. In addition to the optimisation measures taken by the Company, our financial performance was further supported by the fact that sold diamonds are no longer subject to export duty, and also by reduced rates for the electricity consumed.

ALROSA’s net profit in 2017 amounted to RUB 78.6 bn, 41% down against 2016. Apart from EBITDA decline, net profit was affected by lower exchange gains (down by almost RUB 22 bn) and revaluation of gas assets sold in February 2018 (RUB 5.7 bn). Thanks to constructive and well-coordinated work with SOGAZ in assessing damage and loss of fixed assets after the Mir accident, at the end of the year we recorded RUB 10.5 bn in receivables from our insurance compensation to be paid in 2018.

The Company’s CAPEX in 2017 amounted to RUB 26.9 bn, down 15% year-on-year due to the completion of active construction operations at the Udachny underground mine. We expect CAPEX in 2018 to be somewhat higher than in 2017 and estimate it at around RUB 30–32 bn as our capital investments in the development of the Verkhne-Munskoye deposit will peak. Liquidity of the Company remains high, with RUB 73.5 bn of free cash flow in 2017 and 0.7x Net Debt/EBITDA ratio as at 31 December 2017. In the current quarter, ALROSA’s liquidity was further supported by the sale of gas assets for RUB 30.3 bn. In March 2018, we used the proceeds from the sale of these non-core assets for early repayment of USD 450 mln in bank loans. We plan to repay another USD 150 mln next week.

This concludes my presentation, and we are now ready to answer your questions.

Questions and Answers

Dan Shaw – Morgan Stanley

I have a couple of questions.

The first one is capital allocation. The CAPEX is falling, the balance sheet is very strong, especially when we factor in the cash inflow from the sale of gas assets in Q1. What does the Board need to see before it is comfortable in increasing dividend payout to shareholders above 50% on a sustainable basis? If you look at the steel companies, they have done this quite well, and I think the market is ready to reward that kind of behaviour.

My second question follows up on the first one. Luaxe, given the Mir outage, has moved up the list of priorities. Can you talk about the key milestones you see here and give any indications around the timing of potential investment decisions and production?

And the last question on pricing. The January and February sales have been pretty strong. Can you give an indication of whether this is more volume or price driven? Can you also give any indication on where revenue per carat can settle for this year – although I appreciate there is still a long way to go.

Sergey Ivanov (translated)

Let me handle the first two questions. Regarding the dividends: at this point, we do not envisage any change in the dividend policy. Frankly speaking, we do not think that over 50% of net income under IFRS would be paid out in this particular year. It is up to the shareholders to decide, and so far the Supervisory Board has not considered this matter. In the middle of the year, the Supervisory Board, i.e. the Board of Directors, is going to look at ALROSA’s liquidity in general and further discuss the dividend policy.
Regarding the second question on Luaxe: at this point there is no further update in addition to what has already been disclosed to investors previously. Our company Catoca is involved in Luaxe with overburden operations, while the Yakutniproalmaz research institute is considering further approaches to this particular site.

The third question on the market situation and pricing going forward will be handled by Mr Yuri Okoyomov, Deputy CEO for Sales.

Yuri Okoyomov (translated)

We indeed see a strong demand for rough diamonds in early 2018. We are reporting strong sales in January and February, and March is going to produce figures no worse than those. It must be noted that sales of diamond jewellery went very well in the Christmas holiday season in the United States, which is the largest consumer market of jewellery diamonds. Also, the Chinese New Year holiday season demonstrated sales that are stronger than expected. Hence, what we are observing today is very active restocking by the retailers and by cutters and polishers, as a consequence. This results in stronger demand for rough diamonds. Responding directly to your question whether the high demand is driven by volumes or by the price, the answer is volumes. In the first couple of months in 2018, we marked a moderate growth in the average diamond price index for the production of ALROSA and some very good sales in volume (i.e. absolute) terms.

Regarding your request to produce guidance on the average price per carat, it would be too early to give any numbers at this point, but I expect it to be somewhat higher compared to 2017 and somewhat less than in 2016. This is driven, among other things, by the difference in the product mix across these years. Considering the overall movement of the price index across the year, we expect 2018 to be rather stable, with natural seasonal fluctuations on the demand and average price side, usual for a normal year.

Sergey Donskoy – Société Générale

I have two questions. First, a follow-up on prices: last year, you experienced significant volatility in the average realised price of gem diamonds over quarters. In Q4, the average price dropped by 18% q-o-q. By our estimates, your colleagues at De Beers did not see the same decline. Was the price correction caused by some one-offs that affected Q4, and then we can expect recovery or normalisation in Q1, or, conversely, was this the return to normal after abnormally high prices in Q3?

Second, your CAPEX last year was materially below guidance. What is your CAPEX budget for 2018? Do you expect it to be higher now (if any activities have been carried over), and why was CAPEX lower than expected?

Third, you reported an increase of about RUB 3 bn y-o-y in income from grants as part of your topline. Was it a one-off increase, or should we now expect this higher level of grants to be a stable feature, or will there be some reduction this year?

Finally, what inflation in cash costs per carat, or per ton of ore milled, do you expect this year?

Yuri Okoyomov (translated)

As for the first question regarding the average realised price per carat and the difference between Q3 and Q4 2017, the average realised price will definitely be different q-o-q due to changes in the product mix. In Q3 2017, we saw an increase in the sales of our larger-size stones starting from 10.8 carats, while in Q4 2017 these stones went down in terms of their contribution to the product mix, with a larger share of
small stones and industrial diamonds being sold. As for Q1 2018, we do not expect any material shift towards either larger or smaller stones in the mix, hence we would expect the sales mix to be on par with the production mix.

Igor Sobolev (translated)

In 2017, the Company’s CAPEX was below guidance thanks to cost-cutting initiatives and optimisation of technical upgrade programme costs. In 2018, our CAPEX is going to stand at RUB 31–32 bn, and we do not expect any significant change to that mid-term.

Alexey Philippovskiy (translated)

The change in the grants that we receive from the government is explained by the shift in tariffs, especially those for the electric power generated in the Far Eastern Federal District of Russia. We operate the Vilyuiskaya HPP-3 in that region, which, starting since 2H 2017, received a larger portion of government grants to compensate for the electricity tariffs. In 2018, the grant will be effective for the full year, so the total amount of grants received is going to be higher. On top of that, we receive subsidies and grants for carrying air passengers and for water and heat supply to municipal districts, but those are not expected to change.

As for cash costs per carat in the long- and mid-term, there are two drivers here. First, it is the grade, or the share of carats per ton of ore, which is coming down explained first and foremost by discontinued production at the Mir underground mine and increased production at Severalmaz and Verkhne-Munskoye deposits, which are characterized by somewhat lower grade. The second main driver is the overall cost inflation, which is most pronounced in labor, energy and materials. In 2018, we expect to maintain our cash cost per carat on par with 2017 thanks to cost optimisation initiatives, while in the mid- and longer-term perspectives, the costs per carat are going to inflate in line with the overall inflation across these three major areas: labor, energy and materials.

Boris Sinitsyn – VTB Capital

Two questions from our side. The first one is on the sales outlook for Q1 and for the rest of the year. Given the strong start of the year, do you expect the need for rough diamonds by midstream, provided the current market trends persist, to also continue into Q2, Q3 and Q4, or could strong Q1 sales be followed by some slowdown in the coming quarters?

The second question is on your Catoca stake purchase. Earlier, you mentioned plans to buy an 8% stake, but in your earnings report, you mention a 16% prepayment. Have the plans changed and are you now planning to purchase a higher stake from the Brazilian shareholder?

Yuri Okoyomov (translated)

We do not expect the first two months of sales in 2018 to translate into Q2 and further down into the year. There are two main drivers at play here: first and foremost, stronger retail sales of diamond jewelry, which were higher than originally expected based on the somewhat stagnating market of 2015 and 2016, which led to restocking to support growth and in view of the demand upside. Overall, we do not expect the very strong performance of Q1 to last throughout the year, but we do expect a stable year with some seasonal fluctuations, which is normal. Overall, we expect a somewhat better average realised price in FY2018; however, the amount in volume terms may be somewhat lower.
To follow up on the first question, we do not share the optimism of some analysts. Naturally, Q1 is a season of high demand, but we cannot expect its high figures to be translated equally into Q2 and Q3, and that is normal. Overall, the year started off good, which gives us reason to expect somewhat better results.

As for Catoca, this was driven by certain features of the Angolan legislation, and I am going to explain the difference between our comments and the official counts. Indeed, we have acquired a 16.4% stake in Catoca from the Brazilian shareholder Odebrecht, and we are going to sell to Angola’s state company Endiama 8.2% out of the 16.4% acquired. At the same time, we are going to be offering scheduled payments in instalments to Angola’s Endiama as a paid service on conditions that are favorable for ALROSA.

A follow-up on the second question. In terms of your balance sheet – do you plan to recognize the 16.4% stake until your Angolan partner buys it out, or are you going to redirect it as soon as you receive it from the Brazilian shareholder?

The 16.4% stake is already on the balance sheet of our 100% subsidiary. Endiama is going to acquire half of that stake during the year, and, again, they are going pay in instalments as part of a paid service with favorable terms for ALROSA.

I have two questions. The first one is on your inventory. What was your inventory at the year-end 2017 and the year-end 2016? I remember the number of 19.6 mln carats, but it looks like I could be mistaken.

The second question is on your product mix in your production. Has it changed in 2016–2017 compared to the previous three years?

As at the year-end 2016, the inventories stood at 19.9 mln carats, while at the year-end 2017 we had 18.2 mln carats, which is a 10% decrease.

Regarding the average price per carat in our production mix, it has come down due to the increase in production at our Severalmaz deposit, where the value is somewhat less than elsewhere in Yakutia. The average price across the board is going to decrease as we further ramp up production at Severalmaz, but that decrease is not going to be significant. The average grade does not change much over the life of a single particular deposit, other than the times when we move from one block of an ore body to another. If we consider the grade as an aggregated total for the whole Company, it will only change if we produce more or less from a particular deposit with a higher or lower grade.

Mr Ivanov, with a year of experience now as a CEO, do you see any specific opportunities whether on the asset base, cost side, sales strategy or anything else to increase the market capitalisation of the Company?
Can you share your thoughts on the key ideas you have? In what timeframe it might be realisable? Second, coming back to unit costs, we see the key cost items such as wages, materials, SG&A lines are all either flat or lower during the year, but it is very difficult to translate that into units. Do you have an estimate of how unit costs developed in 2017?

Sergey Ivanov  (translated)

Regarding the market capitalisation, I have a strong faith in the Company, and I have a strong belief that the market capitalization is going to grow. I never reduced my involvement and my stake with the Company even after the Mir underground mine accident. Actually, we have gained the market capitalisation to a level above of what we had before the accident at the Mir underground mine, which proves that the market has a strong faith in the Company as well. Regarding the particular measures I am going to undertake in my role, they are day-to-day rather than one-off. That means keeping costs under control, reducing the working capital, follow-up exploration projects in Yakutia, projects in Angola, including new projects there, industrialisation of business processes to automate them across the Company, introduction of innovations and improvements of overall processes and production stages, such as the IT systems, for example, so that we could have a cutting-edge EMS to be as efficient and flexible in managing this business as possible.

Alexey Philippovskiy  (translated)

Regarding the second question, we are tracking two unit costs, and that is the cost per carat and the cost per cubic meter of rock mass. If you look at our IFRS accounts and take all the costs from that and adjust that for any changes in the energy tariff, the changes in export duty which was discontinued, and further one-off elements such as our contribution to the DPA budget and the Mir underground mine recovery costs, then you will see that our cost per carat went down by 2% in 2017, while the cost per cubic meter of rock mass went down by 7% in 2017. Going forward we plan to provide cost per unit dynamics analysis and its reconciliation to the IFRS accounts in the investor presentation on our website.

Anna Antonova – J.P. Morgan

Could you please clarify on CAPEX? You said that you did not expect any changes to your CAPEX spending in the mid-term. Do you expect your CAPEX to remain at around RUB 30 bn per annum starting from 2019, or did you mean that there are no changes to the CAPEX plans announced in your January presentation, which stated that you CAPEX will be around RUB 26 bn in 2019 and RUB 28 bn in 2020? Second, 2017 marked the seventh consecutive year of your working capital build-up. In light of this, how should we think about your working capital developments this year and going forward?

Alexey Philippovskiy  (translated)

Regarding our CAPEX forecast, indeed, the numbers from our presentation you have quoted represent our best guidance in this regard. I would like to make a reservation here: the numbers could be further clarified or adjusted as we consider various options to approach the Mir underground mine recovery, because the numbers currently cited do not envisage any costs to that effect, and as we finalise and disclose our strategy which we are going to complete by the end of H1 2018 and present to the investment community during the Capital Markets Day in Q3. Regarding your second question on the working capital, the increase in 2017 is mostly explained by the receivables of RUB 10.5 bn, which is the accrued insurance payment for the Mir underground mine. In 2018, we are going to receive the compensation from the insurance company and thus reduce our working capital appropriately. In the mid-term, we expect to see a return to 2016 level, normalised, which is 94 days of turnover.
Anton Fedotov – Bank of America Merrill Lynch

My first question is on your sales volumes in 2018. Your production guidance is 36.6 mln carats. What is your guidance in sales? I would expect them to be above the production this year. The second question is about the Mir mine. If you do not take any decision this year to resume the production at the Mir mine or to start some works to resume the production in the future, should there be any impairment of the remaining equipment in the mine? Earlier, you mentioned that there is equipment worth about RUB 15 bn currently in the mine.

Yuri Okoyomov (translated)

Indeed, in carat terms, our 2018 sales are going to exceed production, which is currently guided at 36.6 mln carats. It is too early to disclose any precise guidance given the uncertainties in the potential market movements in the short-term perspective and until the end of the year, but I would be considering a number close to 40 mln carats.

Alexey Philippovskiy (translated)

Regarding potential write-offs of assets linked to the Mir underground mine, in 2017, we wrote off RUB 8.4 bn worth of equipment, which is all the underground part of the mine and all the mining equipment located underground at the time when the disaster struck. We currently have on our balance sheet RUB 13.3 bn worth of the above ground equipment which is going to be written off only in case the decision is taken that further production or resumption is unfeasible. If we decide to resume production or postpone the decision to further periods, then there will be no write-offs.

Pierre Safa – Silver River Capital

Regarding your Endiama 8.2% stake that the government will be buying back from ALROSA, you said that it should happen over the course of 2018. By the end of 2018, that 8.2% will have been completely bought back by the government? Second, in Q3, you gave us a very good colour on the state of the mid-stream profitability and margins discussing the net balance of exports vs imports in India. If you could update us on that number, that would be very helpful. The last question is why do you believe analysts to be overly optimistic on the state of the market? What warns caution, in your opinion, because all indicators seem to be pointing to mid-single digit price increases on a per-carat basis and the market seems to be relatively strong?

Sergey Ivanov (translated)

Regarding Endiama, indeed, we can confirm that Endiama is going to acquire 8.2% stake by the end of the year. However, if it does not happen, there is no risk that we can see, because we are offering to them a payment deferral at a fee and the terms of that particular transaction are very favorable for ALROSA. Regarding question 3 of yours, I have seen a number of reports where the analysts marked a material supply/demand disproportion to be expected in the course of 2018. They extrapolate rather straightforward the very strong Q1 demand on the volume side to Q2 and Q3, which is abnormal for the market. Normally, Q2 and Q3 demonstrate weaker numbers. On top of that, you must add the major scandal in India, when loans were granted to cutters and polishers, and there is definitely going to be stronger KYC and compliance procedures introduced by the banks. Overall, we can say that Q2 and Q3 are going to show stable demand, but below the significant volume of Q1, of course. We expect that the overall average price is not going to change, however, there may be an increase or decrease in average price for a particular group of stones within the product mix.
Yuri Okoyomov (translated)

Regarding the inventories and the margins of Indian cutters and polishers, when we produced the Q3 updates, we did demonstrate the price dynamics. We can see that they have some normal margins. At least their margins are not falling, that is for sure. We provided you with the numbers of net imports of rough diamonds and net exports of polished diamonds into and from India. In 2016, that balance was positive at USD 4.6 bn, while in 2017, it came somewhat down but still remained positive at USD 3.5 bn. Please be mindful that the full year of 2017 saw a global increase of production of rough diamonds. In 2016, a total of 134 mln carats were produced across the world, while in 2017, the number stood at 146 mln carats. According to early assessments, 2018 numbers are going to be closer to 2017 rather than 2016 ones. Overall, we are not overly optimistic regarding the gap between supply and demand, as based on the results in Q1, we can obviously see the restocking exercise alongside with certain seasonal fluctuations. In a nutshell, we expect a rather stable year in terms of demand, with the price remaining flat for the full year, with the certain fluctuations due to seasonal elements and also volatility of particular groups of diamonds within the mix as explained by Mr Ivanov.