EVRAZ plc

FY 2016 financial results conference call
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Speakers:
• Alexander Frolov
• Nikolay Ivanov

MANAGEMENT DISCUSSION

Operator
Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to today's EVRAZ Full-Year 2016 Financial Results Conference Call. At this time, all participants are in a listen-only mode. There will be a presentation followed by question-and-answer session. [Operator Instructions].

I must advise you that this conference is being recorded today, Wednesday, 1st of March, 2017. I would now like to hand the conference over to your speaker today, Mr. Alexander Frolov. Please go ahead, sir.

Alexander Frolov
Good afternoon, ladies and gentlemen. I would like to welcome you to our conference call to discuss financial and operating results of EVRAZ for the year of 2016. I hope you have had an opportunity to download the presentation, that is available on our website, evraz.com, as we will be following it during the call.

Traditionally, before I begin, I would like to remind everyone that the matter discussed on this call will include forward-looking statements that are subject to many factors, risks and uncertainties that are described in detailed on the second page of the presentation. We undertake no obligation to update any forward-looking statements.

Today, on this call, I'm being joined by our new CFO, Nikolay Ivanov, whom I'm very pleased to introduced and - to introduce; and Sergey Stepanov, Head of our Coal Division. I will begin by outlining key messages of today's presentation, followed by strategic update. I will then turn the call to Nikolay, who will give us the financial results in detail. Sergey will be available for all of your questions on call, during our Q&A session.

Now, let's turn to the slides. We start on page 5, but during 2016 we have seen positive trends in steel prices as well as a very sharp increase in coal prices, which are now softening, but still remain on those - on the level higher than a year ago. Iron ore prices are also on a positive trend recently. At the same time structural capacity stays in place and the effect of China influence on the global supply demand equation remains as uncertain as before.

In overseas, our prime focus in 2016 was on EBITDA improvements. Development of our product portfolio has brought us $169 million in U.S. and cost-cutting measures brought another $316 million EBITDA improvements. As a result, our EBITDA reached $1.542 billion and our net debt has decreased by a half a billion down to $4.8 billion with a Net Debt/EBITDA ratio is 3.1x at the end of 2016.

So, if I turn on page 6. On this slide, I would like to say a few words about safety, which remains our top priority. We have ended 2016 with six fatalities and slightly increased Lost Time Injury Frequency Rate. Our LTIFR number showed mix dynamics, which is more to linked to our continue to work to improve transparency of our reporting. Our long-term goal here is the same as before, zero fatalities and LTIFR below 1.0x.

On slide 7, I would like to remind you what our strategic priorities are. First, it is development of our product portfolio and retention of our low cost position. We also remain cautious with our capital expenditures, and we're continuously pushing our net debt down.

So slide 8, here I want to give you a more details about our product portfolio development. As you know, we are number one producer of rails globally, the Russian market remains priority for us, but we also development export sales of rails out of Russia. We are leading producer of construction steel, and we put a lot of efforts to promote more advanced construction technologies allowing replacement of concrete with our steel profiles from the territory of Russian Federation.

2016 was a good year for our coal segment. We believe that EVRAZ will benefit from longer-term market improvements here, and as well as from our ability to enhance efficiency of our coal operations.

In North America in 2016, because we made material investments to upgrade our steel mill in Regina. And we have also built new large-diameter pipe mills there. We are now well-positioned to improve our share in North American large-diameter pipe market.

So slide 9, retention of low cost position is another priority for us as already said. As you can see our cost of slabs, iron ore and coking coal in 2016 was lower than in 2015, which allowed us to benefit from positive market trends in all the segments.

So moving on page 10, we have reduced our CapEx spend in recent years after completion of our major projects like rail mill reconstruction in Novokuznetsk, development of Yerunakovskaya-8 mine and some other. In 2017, we expect moderate CapEx growth linked mainly to the construction of blast furnace 7 in Nizhnij Tagili. CapEx in coal segments would also increase slightly, but this would allow us to get immediate benefits from the improved coal market conditions.

As you can see on slide 11, our debt reduction trend is very consistent and we have achieved great results since 2013 and 2016 specifically. Net debt has gone down to $4.8 billion and net leverage is $3.1 million. We will continue our effort here with the medium-term target to bring down our net debt to EBITDA ratio dilutive.

On slide 12, we are providing you with a brief summary of our achievements in 2016. In the context of our strategic priorities. As you can see here, major EBITDA effects $1.65 million and $316 million attributed to customer focus initiatives and cost cutting program respectively. As was the other two priorities that have already mentioned. Our prudent CapEx strategy and our progress with the net debt reduction.

So with it over to Nikolay Ivanov, who would you walk you through financial areas. So, Nikolay please.

Nikolay Ivanov

Thank you, Alexander and good afternoon, everybody. Before I turn to the slides, I would like to emphasize on the fact that 2016 was quite a good year for EVRAZ, especially the second half of the year. Our revenue and EBITDA in the first six months of 2016 have been negatively affected by unsustainable low prices for steel and raw material, and decrease demand especially in the first quarter. The second half of the year show a significant pickup and recovery both in steel and in coal sectors. We were able to deliver strong positive free cash flow and reduce enough debt.

Now moving to slide 14 please. I would like to start with an overview of our financial performance here. Our full-year EBITDA demonstrated a 7.2% increase to previous year mainly due to numerous improvement initiatives and more favorable market conditions in the second half of 2016, as I have already mentioned.

Our EBITDA margin recovered to 20% in the reporting period and review of our cost efficiency matters and market initiatives. Steel segment performance in 2016 is a result of comparatively loss market conditions in 2016 versus 2015. EBITDA fell amid negative fuel price trends and a reduction in sales volume.

The Coal segment on the other hand, benefited from significant price increase, healthy demand and productivity improvements, leading to 83.5% increase of EBITDA to $644 million. Year 2016 was a rather challenging one for our North American business. Key drivers of such performance were significant reduction in year wise North American OCTG sales, resulting from a market slump in mid-to-low oil prices, big tubular and rail markets in North America and delays in pipeline projects.

Our unallocated expenses, which are our corporate overheads, decreased to $109 million from $130 million a year earlier. Eliminations mostly reflect unrealized profits or losses that relate to the [indiscernible] entries on inter-company transactions.

Moving to slide 15, please. Our free cash flow for the year remained quite strong, $659 million and it allows us to further reduce our debt. Net cash flows from operating activities decreased slightly by 7.3%, compared to this 2015 and $160 million was attributed to the release in net working capital.

Moving to the next slide, slide 16. With our continuous focus on debt reduction, we have undertaken several re-financing initiatives during 2016 in various debt markets to proactively extend short-term debt maturities and reduce the cost of our debt.

$765 million across 2017, 2018, EVRAZ and Raspadskaya euro bonds was repurchased in 2016 on the market and public tender offers. We used all available sources of financing, including bank loans and capital market facilities, including our RUB 15 billion bond issued in March and $500 million Eurobond issued in June.

Remaining $177 million principal over the 2017 Eurobonds was called in full and settled in August. During 2016, in order to reduce total debt and interest expense, as well as to extend the maturity profile, EVRAZ also prepaid several bank facilities. As a result of this effort, our average maturity rose to 3.3 years.

Our gross debt went down by $763 million and fell below $6 billion and our net debt also decreased by more than $0.5 billion and is now standing at $4.5 billion.

As of December 31, 2016, EVRAZ was in full compliance with its financial covenants. Cash amounted to more than $1.1 billion and short-term loans and current portion of long-term debt stood at $392 million. Cash on hand and committed credit facilities are positioned to cover all of EVRAZ debt principle maturing in 2017 and 2018.

Going to the slide, 17. I would like to elaborate on development CapEx and our key investment projects. Over the last five years, EVRAZ completed a substantial investment program. Current investment projects are focused on efficiency improvement and selective product portfolio developments.

Main highlights here are two projects at EVRAZ Regina in Canada with the launch scheduled in the first quarter of 2017, the Mezhegey coal mine project launched in the second quarter of 2016 and is now ramping up production volumes and the EVRAZ NTMK grinding ball mill construction project and also the Blast Furnace 7 project. First iron is scheduled at the end of 2017, beginning of 2018.
Capital expenditures are summarized for your convenience in a table on the slide. Over the mid-year term, maintenance CapEx may increase to support current key capacities like the construction of a new Blast Furnace at EVRAZ NTMK and higher CapEx to maintain coking coal mine probes.

On slide 19, we summed up outlook points for 2017. Generally, our view is such that even though commodity price seems to be stabilized and the whole steel market sees relative improvement versus the beginning of 2016. The overall performance operating environment remains complex and volatile. The key risk that we see here, are the uncertainty around further Chinese capacity cost, another development in China, as well as the general [indiscernible].

Given the current environment EVRAZ remained focused on cost efficiency and product development, which will support its financial stability and enable it to deliver stronger financial results going forward. We continue to expect positive free cash flow and progress towards reducing net debt in absolute terms.

With this, I would like to thank you for listening to our presentation. We have a few slides, now operational performance does in the presentation, which we decided not to talk so important there, give you more time for your questions.

I also will take this opportunity to tell that our annual report for 2016 has been released today, there you can find comprehensive information, and in depth detail on our performance in 2016. And now, we are ready to take your questions. Thank you.

Q&A

Operator
Thank you. Ladies and gentlemen, we'll now begin the question-and-answer session. [Operator Instructions] Your first question is coming from the line of Damien Sham. Okay now please go ahead.

<Q - Damien Sham >: Hi. Thank you for the presentation. I have couple of questions. You mentioned slightly high CapEx guidance for full-year 2017 and 2018 of USD $550 million, is this primarily on the back of maintaining - increase in maintenance CapEx, can you just please provide more details. And also with respect to your short-term debt, you don't have significant maturities this year but slightly high maturities in 2018, given fairly low cost of borrowing in the international bond markets, are you considering any refinancing this year. Thank you.

<A - Alexander Frolov>: Well, that's Alexander Frolov, let me quickly answer your first about CapEx. As I mentioned, let's say maintenance CapEx would not change much. The only a sort of significant change, we see it is on a coal side. But again it's not something let say - there are no less any kind of big, let say, projects or changes that, we're just making some efforts to maximize current production, or let's say to get quick returns and quick volumes of additional coal, which would allow us to benefit from the current market conditions. So, this kind of maintenance was very quick pay back. And on the debt…

<A - Nikolay Ivanov>: On the debt - I mean this is Nikolay, yes as I mentioned, we don't need to pay back a lot of debt in the year 2017, it's below $400 million. And the next significant payment needs to be done only in 2018 when our bonds mature. So with high cash liquidity, which is in excess of $1.1 billion, we don't see an immediate need, but I would agree with you that the markets are very, very, very strong, and we are monitoring them very, very closely. So, if we believe that it's beneficial for the company to enter the market, we will definitely do that.

< **Q - Damien Sham** >: Okay. Thank you very much.

Operator
Thank you. Your next question is coming from the line of Alan Spence. Please go ahead.

<**Q - Alan Spence** >: Hi. Thank you. I had a few question. Looking at the U.S. operations, what percentage of the crude steel input comes from overseas production facilities? If we were to see a border tax, what would be the ability to source your inputs to the crude steel domestically within the U.S.? Also within the U.S., if we talk about the Keystone pipeline, do the old contracted volume still hold? Or is there a need for the pipeline to rebuy? And also with the announcement that the U.S. pipelines need to be made in the U.S. to the maximum extent possible. What impact does that have on your ability to supply volumes to it? And, I have one last one, but I'll let you answer those first please.

< **A - Alexander Frolov** >: Could you say - tell what your question is?

< **Q - Alan Spence** >: So the last one is just about the loss on - the realized loss on derivatives this year, if we could just have a little bit more background about what that was?

< **A - Alexander Frolov** >: I'm not sure that, I understood correctly, your first question about our crude steel space sourcing in the United States, just for clarification, we have three production sites there. One is Portland, which is a rolling mill and this mill mostly sledged - slabs by the use [indiscernible]. So then another site, is in China, which is electric arc furnace and the main product there we are making large-diameter pipes and some OCTG pipes, and the third side is our mill in Pueblo where the main product is rail, some seamless pipes and some ribbons. So clearly the first one is sourcing material overseas, let's say to source material locally would be pretty difficult because, let's say the cloth is the - let's say steel making will be relatively far away, but I guess that historically it was strengths of our business model important, because we are not relying on, let's say, fully integrated steel making and we have been quite flexible buying slabs when needed and at the price which was, let's say, matching current market price. I'm not sure that it answer - if let's say, doesn't answer your question, then please, let's say, make a follow-up.

Let's say talking about - let's say, Mr. Trump statements that pipes in U.S. would be made fully in U.S., I guess at this stage it's very early to say what sort of impact, it would finally make because Secretary of Commerce, which was appointed just yesterday has got 180 days to work out on this matter. And we just have to be patient to see what will happen.

We don't really understand, let's say, how it could impact our business because we don't understand was at a legal big, could be defined the changes. But again, we just need to wait and see. On - let's say losses, I think, yes [indiscernible].

< **A - Nikolay Ivanov** >: Yes, the question was with regards to the gains and losses on derivatives. So to manage the currency exposure on the ruble denominated bonds, the company partially hedged to those transactions. It took place in 2010, 2013, during that period of time. So basically what the company did. We concluded currency swaps under which we agreed to deliver the U.S. dollar denominated interest payments and notional amount and exchange for ruble denominated interest payment and notional amounts. So this support contracts were not designed as hedge - were not designed as cash hedges. And we count for this swaps at a fair value. So the net results, which we disclosed in our financial exposure year 2016, is $23 million gain. We - this is rated for swap contracts matured in the year 2014 and 2016. So for those swaps, I don't think we will be showing any - they will not give any impact on our income or loss in the current year.

< **Q - Alan Spence** >: Just one quick follow-up. I was more referring to the $250 million of realized losses.

< **A - Nikolay Ivanov** >: Yes. I have spoken about you need to net it with $273 million of unrealized gains.

< **Q - Alan Spence** >: Got it.

< **A - Nikolay Ivanov** >: So that's sector of those is 23 positive, yes.

< **Q - Alan Spence** >: Got it. Understood.

< **A - Nikolay Ivanov** >: Yeah. And for more information, you can look at Item 25 in our financial statements.

< **Q - Alan Spence** >: That's great. Thank you very much for answering my question.

Operator
Thank you. Your next question is coming from the line of Nikolay Sosnovskiy. Please go ahead.

<**Q - Nikolay Sosnovskiy**>: Yes, hello. Thanks a lot. Few questions from my side as well. First, on mining mine imports 00:24:04in Russia in 2017, what is your assessment on this year performance? I mean, globally it was rising in the back 00:24:19of fuel, currencies, what would be your assessment for, iron ore and coking coal cost this year, that's my first question.

< **A - Alexander Frolov** >: Is it cost or price?

< **Q - Nikolay Sosnovskiy** >: Cost, cost of production.

< **A - Alexander Frolov** >: Okay. Okay. Is it the only question, shall I?

< **Q - Nikolay Sosnovskiy** >: No. The second question is on dividends, because it seems like that the first half of 2017 would be even stronger compared to second half of 2016, in terms of financials and you may well go below 2.5 times net debt to EBITDA. Will that trigger dividend payments after the first half and if yes, what could be the potential amount and overall, your desire in splitting free cash flow between dividends and further leverage reduction?

< **A - Alexander Frolov** >: Okay. So starting from your last question, our dividend policy is that we don't pay any dividend if let's say net debt to EBITDA ratio is above 3x. If this ratio would go below 3x, which is very likely to happen on the back of first-half of 2017 results, then our board would consider how to distribute the cash flow and our prime goal would remain, let's say to reduce the debt. Because we believe as I said earlier that our comfortable zone is below two. At the same time, I do not exclude the possibility that as the board may decide to pay some dividends, but it's primary to you to discuss this subject right now.

Talking about the cost on mining, we do not expect any major increase in 2017. So, our volumes remain in more or less the same which sounds like goals and we have number of measures let's say how to improve efficiencies. So, I would expect as a flat or let's say some reduction, if I speak about correct on this.

< **Q - Nikolay Sosnovskiy** >: That's in rubles or in U.S. dollars?

< **A - Alexander Frolov** >: I will say this is - we can even say rubles.

< **Q - Nikolay Sosnovskiy** >: Okay. Thank you.

Operator
Thank you. And your next question is coming from the line of Joe Lebetsa. Please go ahead.

< **Q - Joe Lebetsa** >: Hi there. Congratulations on the great results. I just wanted to follow-up on the question on liability management. It seem successfully issuance from [indiscernible] result. And I want to know if you were to do some liability management, would you be looking to clear up the short-end of the curve or would you be looking to bring down your interest expense since look at your higher coupon outstanding. And if you were to do some large business management, are you more inclined to the revenue base that you are seeing from local banks, so would you more incline to come to the market or would you be looking to vitalize from locals? Thank you.

< **A - Nikolay Ivanov** >: Okay. Thanks very much. I don't think we have an exact strategy. So currently about two-thirds of our debt is public debt and one-third of debt is a bank debt and we are quite comfortable with the current breakdown. So, there is no exact plans with regards to the liability management, if we'll go to the public markets or to the bank, so we're just monitoring the market as a team. And we'll use those instruments which we believe are the most beneficial for your rest of the card moment of time.

With regards to the maturity levels, we believe that - we're quite satisfied to the current levels, so as the company has been able to significantly extend the maturity, but we believe there is a room for more extension. So moving it into the sort of period and increasing the average life of debt.

< **Q - Joe Lebetsa** >: Okay. So the aim would be to increase the average after the debt, not necessary to adjust the interest expense?

< **A - Nikolay Ivanov** >: I wouldn't exclude debt task as well, I mean our average cost of debt slightly increased in the year 2016, because we slightly increased the share of ruble debt on our balance sheet and this debt from the nominal standpoint at least is a bit more expensive. So we certainly are looking for the potential to decrease our cost of debt and as you can see the markets are very, very good for this right now.

< **Q - Joe Lebetsa** >: Okay, brilliant. Thank you very much.

Operator
Thank you. And your next question is coming from the line of George Buzhenitsa. Please go ahead.

<**Q - George Buzhenitsa**>: Good afternoon, gentlemen. Thank you for the opportunity and congratulations on the results. I have a few questions. The first one is one working capital, I can see it has turned negative in 2016. Do you think this is a sustainable level of working capital you can run a business on?

The second question is on Nakhoka Sea Port. I think there was some news suggesting that you might be willing to dispose of that asset. Can you please confirm that and if you do, can you please give us an indication when the deal could be closed?

And the third question is on your North American business. I can see that the SG&A cost in North America or the implied SG&A cost according to my calculations is at approximately 20% of revenues? Is this because revenues have gone down so much and SG&A, was quite stable and it's a temporary thing or there is something structural about that? Thank you.

< **A - Alexander Frolov** >: Okay. The third example of, I dealt very much that G&A percentage in North America is as high as you have mentioned. We can double check that one of one, my understanding is and I have very kind of regular and detailed discussion with the management about SG&A as I think is the level of 70% to compare with earlier.

Let's say, speaking about Nakhodka, we don't think that fundamentally of this asset is core asset for us. At the same time, we are using this port extensively and we would like to continue to getting service from this port. So we have been considering, let's say, number of possibilities of disposal, but I can't say, that at the moment we are anywhere close to any sort of certainty there. It might happen in the future, but probably not short-term. So on the working capital, I guess, Nikolay, he can give you a comment.

<**A - Nikolay Ivanov**>: Yes. On the working capital, yes, you are absolutely right that, there was slightly a low release from the working capital in the year result extreme compared to 2015. But let me assure you that our working capital practices are as robust as they were. The key reason here is that we were witnessing a growth cycle in terms of the prices. So it eventually led to higher cost of inventory on our balance sheet, and higher receivable from our customers. So that's the key reason why the release was flat was flat to small.

< **Q - George Buzhenitsa** >: Very good, Nikolay.

< **A - Nikolay Ivanov** >: Yeah. Sure.

< **Q - George Buzhenitsa** >: Yeah. I think on working capital, my question is it has turned negative and the working capital balance, I mean, and the question is, is this sustainable, do you plan to replenish the working capital until 2017, and on North America...

< **A - Nikolay Ivanov** >: I'm sorry. Can you extrapolate where did you come with this - business conclusion on our 00:33:27[indiscernible] on negative working capital.

< **Q - George Buzhenitsa** >: Well, I'm just calculating it from your financial statements.

< **A - Nikolay Ivanov** >: Okay. If we can return to you offline.

< **A - Alexander Frolov** >: I would probably suggest to put it offline. My general comment would be that there was nothing abnormal for our working capital at the end of the year, and we have been on a level which we believe is sustainable level. So we do not expect any major injection into working capital during 2017, let's put it that way.

< **Q - George Buzhenitsa** >: Thank you.

< **A - Nikolay Ivanov** >: Yes. Thank you. With regards to the impairment, yes, you're absolutely right. The group has recognized an impairment loss in the amount of $465 million for the year 2016, an absolute majority of this impairment loss is related to our assets in North America. So, you also need to understand that this has which is being done on an annual basis, has not been done in February or in January, it was done during the preparation of the financial statement. And that - this year, we did it in the end of quarter. So should we doing it today, I am sure the result would be slightly different, but again, this was an assumption and this would say a loss we recognized when we did our modeling, that is end of the year.

< **Q - George Buzhenitsa** >: Okay, understood. Thank you.

Operator
Thank you. There are no further questions for this time. Please continue. We have another question from Nikolay Sosnovskiy. Please go ahead.

<**Q - Nikolay Sosnovskiy**>: Sorry, I just had a small follow-up on coking coal domestic contracts. Can you point out what's the relevant basis for domestic contracts, is it more linked to hard coking coal quarterly price with semisoft coking coal quarterly prices shall and it will be? Thank you.

< **A - Alexander Frolov** >: Sergey, please.

<**A - Sergey Stepanov**>: Yeah. Its more linked to hard coking coal, but it doesn't reflect its full result, the dynamic will reflect, but sort of the formula based on kind of combination of ration price environment, which was let's say in 2015 when we agreed with more, most of our clients. And second part - first part is kind of ration price reality, second part of hard coking coal goals. So, it's a combination of these two, and yes, that mostly to hard coking coal dynamic.

< **Q - Nikolay Sosnovskiy** >: And another small follow-up if I may. Is it more linked to quarter-over-quarter price performance or the underlying change in netback parity for Russian domestic prices?

< **A - Sergey Stepanov** >: It's quarterly FOB benchmarks, sort of international quarterly FOB benchmarks.

< **Q - Nikolay Sosnovskiy** >: So, it's not expert based netback for Russian domestic prices, just correlative performance. Thank you.

< **Q - Nikolay Sosnovskiy** >: Yeah. Thank you.

Operator
We'll have another question from the line of George Buzhenitsa. Please go ahead.

<**Q - George Buzhenitsa**>: Yes. Once, two more questions, please for me. First one on MUK-96, given the improving price environment for coking coal. Would you consider restoring breaches of that mine? And the second question is on Timir. Can you please update us on the state of affairs there and then, are you still have any outstanding sort of payments to make to overall serve problem for the stake in Timir? Thank you.

< **A - Sergey Stepanov** >: I can answer on MUK-96. So we believe that we have other assets for example, Raspadskaya open-pit, Raspadskaya mine, Erunakovskaya mine, which produce coal with slightly higher quality and all these assets have potential for increase of production if required. So, that's why we would not - we do not plan to launch MUK-96 now, we can ramp up on other assets. So, if we would have enough kind of transportation, sales, logistic and all other conditions.

< **A - Alexander Frolov** >: Okay. And then speaking about Timir, I think that there is still some portion remains to be paid, but it's not material amount. If its answers your question? And not material means what $10 million or something more than that.

< **A - Alexander Frolov** >: Whatever roughly. So, I do not remember exact number.

< **Q - George Buzhenitsa** >: Okay. So, it's minor. Thank you.

Irina Bakhturina
Ladies and gentlemen, if there are no further questions. Would like you to thank you for your interest in EVRAZ and for being with us today on this call. Have a great day. Bye.