EVRAZ plc

EVRAZ H1 2018 Financial Results

Thursday, 9 August 2018

Operator:

Good day and welcome to the H1 2018 Financial Results Conference Call. Today's speakers will be Alexander Frolov, CEO, and Nikolay Ivanov, CFO. As a reminder, today's conference is being recorded. At this time, I would like to turn the conference over to your CEO, Alexander please go ahead, sir.

Alexander Frolov:

Thank you. Good morning ladies and gentlemen. I'm Alexander Frolov, the CEO of EVRAZ. It is my great pleasure to welcome you all to our first half 2018 results conference call. I will start our presentation with short overview and then Nikolay Ivanov, our CFO, will cover finance in more detail.

For the first six months of the year we have delivered another strong set of results, driven by the ongoing improvement in steel and vanadium markets, as well as by our continuous efficiency improvements. As a result, our consolidated EBITDA has surged 65.5% year on year and reached $1.9 billion, pushing the margin to 30%. Our net debt to EBITDA ratio reached 1.1 times, well below our target level and free cash flow generation of $661 million allowed us to announce another interim dividend in the amount of $0.40 per share.

Now moving to safety. Please turn to slide 6. Safety remains a top priority for EVRAZ. Our LTIs demonstrated positive dynamics during this year and we have also managed to decrease the number of severe injuries. Still, despite this progress, tragically seven people lost their lives in the first half of the year. We will continue our [inaudible] effort in this area and remain committed to our target of zero fatalities.

Low cost is another important area for us. As you can see on slide 7, our cash cost of slabs remains practically unchanged, as cooking coke cost increased to some extent due to lower production at Raspadskaya.

Now moving to slide 8. Our strategic priorities stays the same as before. In addition to attention of lower cost position, we continuously work on development of our product portfolio and make sure that our capital projects are solid enough and prioritised in a way that allow us to pay regular dividends to our shareholders.

Slide 9 illustrates our achievement in strategy implementation. Our customer-focused initiative generated additional EBITDA of almost $21 million during the period. We believe that customer focused sales and the effectiveness of product development are the keys to sustain market leadership and to ensure further growth of the business. We have also generated another $117 million of EBITDA improvements via efficiency gains and better yields. We have spent $232 million on CAPEX in the first half of the year. It is 20% less than it was in the first half of 2017, mostly due to successful commissioning of blast furnace number 7 in Nizhny Tagil in March 2018. Our full year CAPEX target is around $600-700 million just as guided previously.

If you turn to page 10 now, we will see that our net leverage reached 1.1 times in the period. We continue to work on deleveraging and at the same time have paid out $617 million of dividends in the first half of 2018. Given solid performance in the first half of the year, as you can see on page 11, EVRAZ have announced another interim dividend of $0.40 per share, a total of $577 million to be paid on 6th September.

To conclude, I would like to say that we are proud of our strong ongoing performance and will remain focused on delivering further improvements. In the second half of the year, despite possible price corrections, we expect market conditions to remain favourable for us. And now I hand across to Nikolay. Nikolay please.

Nikolay Ivanov:

Thank you Alexander and good afternoon everybody. I'm happy to present financial results for the first half of 2018 which demonstrates significant improvement over the same period of 2017.

Going to slide number 13 of the presentation, you can see that EVRAZ's reported EBITDA of $1.9 billion for the first six months of 2018 compared to $1.2 billion for the first half of 2017. This was the highest EBITDA since 2008. Our performance was reported by the growth in global steel market and was accompanied by the fact of cost-cutting conditions.

A few comments on segment performance. In steel we saw revenue growth of 21.4% year on year to $4.4 billion. EBITDA showed significant growth in the period, year on year, and reached almost $1.3 billion. Main drivers were steel and vanadium prices and higher sales volumes of steel products, low expenses in US dollar terms, and the impact of cost-cutting initiatives implemented in the period. The coal segment's revenue climbed by 11% year on year. This was supported by an uptake in sales volume amidst stable demand and improved productivity. Coal prices followed global benchmark trends in the period. EBITDA grew year on year amidst high sales volumes, the impact of cost-cutting initiatives and lower expenses in US dollars because of global deprecation. Still North America revenues soared by 31% year on year, mainly reflecting greater demand for all steel products. EBTIDA growth was driven by greater revenues from sales of construction, tubular and [inaudible] products.

Now moving to slide 14. Our free cash flow is a solid number of $661 million. Changes in working capital are largely explained by the increase in inventories in receivables at our trading companies, driven by output expansion in the view of positive market sentiment as well as by high coal, vanadium and steel product prices.

Moving to the next slide please. Just a few more words about CAPEX, as Alexander has already briefed you on a few minutes ago. During the reported period, EVRAZ's capital expenditures fell to $232 million compared with $289 million in the third half of 2017, when significant expenses was incurred with the blast furnace number seven project. NTMK[?] continued to implement its two main projects, construction of blast furnace number seven and the grinding ball mill construction project. EVRAZ North America began implementing two projects aimed at reducing cost that have catered for completion in 2019. Our CAPEX forecast for 2018 did not change and is approximated to be at the level between $600-700 million

Going to the next slide 16. EVRAZ began 2018 with total debt of $5.4 billion. During first six months of 2018, we used the cash flow generated in the period to further reduce debt and completed several transactions to extend our maturity profile. As a result, total debt was reduced by $646 million to $4.8 million. A net debt decreased by $82 million. The strong performance delivered in the first half of 2018 drove EBITDA growth and further debt reduction, helping to significantly improve our leverage metrics, which fell to 1.1 times as at 30th June 2018 compared with 1.5 times at the beginning of the year. In the first half of the year we made two dividend pay-outs to shareholders. A second interim dividend for 2017 of $0.30 per share and an interim dividend for 2018 of $0.13 per share. Given the performance throughout 2018 on 8th August, the EVRAZ board of directors has declared a second interim dividend for 2018 in the amount of $0.40 per share.

In terms of positive development, I would also like to mention our strong results and improvements. Our credit profile, which was recognised by ratings agencies, resulting in upgrade to BB by Moody's, the stable outlook by Fitch, and the positive outlook by S&P.

To finish off I would like to say that we are very glad to see such strong results. Even though the market support us, we put a lot of effort in our daily activities and strive to improve and expand the business and deliver superior value for shareholders and all stakeholders. For the [year end] outlook, we anticipate that the market prices could decline, particularly international coal and steel benchmarks. However, the overall performance should remain solid, driven by the pipeline of internal improvements and supported by generally strong pricing environment relative to the average levels seen in the last two years.

With this, I would like to thank you for listening to our presentation and we are now ready to take your questions. Thank you.

Operator:

If you would like to ask a question please signal by pressing star one on your telephone keypad. If you were using a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that was star one to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions.

And we'll take our first question from Dan Shaw with Morgan Stanley. Please go ahead.

Dan Shaw:

Hi good afternoon. Couple of questions from me so first one on working capital. Obviously it's a bit of a build-up in the first half. How do you see that developing? In 2H do you expect some of that to unwind? And secondly just on CAPEX you're annualising quite a way below the $600-700 million guidance that you mentioned on your slides. Do you obviously therefore plan a step up in the second half and that that's going to get us sort of $350-400 million in the second half to get us within into that range, or is there some downside risk to the guidance?

And then just finally on vanadium, it looks like you’ve sold some inventory in the first half. Should we expect the opposite in the second half? And also just on pricing there, you talk about moving a proportion of your sales off of contracts and towards spot. Can you give us an indication of – I supposed what's the discount – in terms of what you're selling what's the discount relative to the average benchmark price? And do you see that discount closing over the next six months or so? Thank you.

Alexander Frolov:

Well, let me – that's Alexander Frolov. Let me start answering your questions about vanadium and then Nikolay will comment on working capital and capital expenditure forecast for 2018. When we speak about frame contracts in comparison in the spot market, typically it's just few percent discount. So it's probably not material in terms of our vanadium segment profitability. As you said, because those contract are negotiated basically once a year we don't expect any major change in 2018. If we see some results of, let's say different pricing policy or some adjustments because of the high managing price, it will only happen in 2019. So Nikolay please.

Nikolay Ivanov:

Yes, thank you. So answering to your first question on working capital, negative changes on working capital in the first six months is primarily explained by the increase in inventories and receivables at our trading companies and steel segment, and also in steel segment North America. The key reason for such an increase is the significant increase in prices of pretty much all of the commodities, but especially for steel. Speaking about the forecast in the second half of the year, I believe that the situation with the working capital will stabilise and I do not expect any negative changes in the second half of 2018.

Answering your second question on CAPEX, yes, we do believe that there will be some catch-up in CAPEX spent in the second half. And the indication we just gave you, the CAPEX will be somewhere in the area between $600-700 million, and we confirm that. It might be closer to $600 million, especially taking into account that the ruble is devaluing at a higher rate, during especially the last two days, since 50% of our CAPEX spent is in Russian ruble.

Dan Shaw:

Thank you. And can I just follow up on the working capital? Do you mean that you'll see sort of working capital in the second half will be neutral? Or do you mean that you will see some of the build-up that happened in the first half potentially reverse in the second half?

Nikolay Ivanov:

I believe it's going to be neutral.

Dan Shaw:

Okay thank you.

Operator:

And as a reminder, it is star one if you would like to ask a question. And we'll take our next question from Alexander Kuzovlev from AK Invest. Please go ahead.

Alexander Kuzovlev:

Hello. Thank you gentlemen for great results. I have a question concerning subsidiary company. We know about developing dividend policy in Raspadskaya. But still you don't need policy for such payment, you need net profit. So my question is, does EVRAZ consider getting dividends from Raspadskaya in this calendar year? I mean interim dividends for first half year 2018. Thank you.

Alexander Frolov:

Thank you for your question. We are thinking about Raspadskaya situation and potential of paying dividends there. On the other hand, unfortunately, as you have seen from our results, operational performance of Raspadskaya mine in the first half was not the greatest one. We have lost some production because of changeovers of some long walls. And basically the mine is still struggling a little bit to get to the budgeted production volumes, so this is probably one of the aspects which would potentially influence our decision. And I think right now it's quite premature to speak about any dividends in 2018. I think the higher probability may be in the next year, not this year.

Alexander Kuzovlev:

Okay, thank you.

Operator:

Again, it is star one if you would like to ask a question. And we'll take our next question from Oleg Petropavlovskiy from BCS. Please go ahead.

Oleg Petropavlovskiy:

Good evening this is Alex Pavlovskiy from BCS. Thank you for the presentation. One question from me. Can you please give us some guidance how your US or North American division will be performing in the second half?

Alexander Frolov:

Look, normally we are not giving any detailed forecast on our future performance. I would probably say that for sure our North American business was rather impacted the tariffs which were introduced by United States and afterwards by Canada also during the first half of 2018. So that's why it's quite difficult, let's say, to make any prediction. Because especially in Canada, the situation remains quite difficult for us.

Oleg Petropavlovskiy:

And if we compare, for example, first quarter and second quarter, can you tell us how this division was performing?

Alexander Frolov:

Look I think that the major impact on performance is coming from tariff and tariff from Canada to US will, let's say, become effective more or less at the end of the second quarter. So that's why you would not see a major difference comparing second quarter with the first one.

Oleg Petropavlovskiy:

So we cannot see impact from the tarifs in the first half, right?

Alexander Frolov:

US/Canada no. What you see, you can see impact on tariff on Russian slabs for sure. But US/Canada will be coming only in the second half of this year.

Oleg Petropavlovskiy:

But are you still supplying slabs from Russia to the US and Canada?

Alexander Frolov:

Yes we continue supplying slabs because prices for plate in United States went up significantly. But at the same time, we are spending 25% of whatever [inaudible] price of slabs pay in tariffs and it's not a comfortable position for us. We have requested a possibility of exemption. And we are just waiting an answer from the authorities whether there would be some positive movement there or not.

Oleg Petropavlovskiy:

Okay, thank you very much.

Operator:

And we'll take our next question from Nikolay Sosnovskiy from Prosperity Capital Management. Please go ahead.

Nikolay Sosnovskiy:

Yes hello. Thanks a lot for the presentation. The majority of my questions have been answered already. But I still wanted to ask you on your M&A strategy. In the past 12 months, let's say, you had quite a bit of deals that supported your free cash flow generation like sales of Ukrainian assets, your equity investments and so forth. It would be really interesting to hear your current thoughts on what still remains within the group, maybe some non-core assets or some investments that can be divested as well and that can support free cash flow generation and dividend payments. This, for example, I know free floats in Raspadskaya, North American division, IPO, all of these fall into this category as well. Thank you.

Alexander Frolov:

Again, it's a little bit difficult to answer because possibilities you have mentioned, they are working in different direction in terms of the improvement of cash flow or a contrary, let's say, in the use of cash flow. But in general my answer would be the following. We don't have any immediate targets either for disposal or acquisitions. So basically there is nothing to comment here.

Nikolay Sosnovskiy:

Okay, thank you.

Operator:

And we'll take our next question from Andrew Jones from Wood & Company. Please go ahead.

Andrew Jones:

Hi gents, I just have a few questions. Firstly, just on the North American division. How much of your Canadian sales go to the US currently? Or can you give us the figures for 2017? Secondly, at the Portland asset which was paying tariffs in the second quarter, you probably have an idea of profitability right now. Given how high US stock prices are, I mean how much EBITDA per ton are you currently making at that asset? And just thirdly on the dividends, payment so far seem to have been fairly ad hoc. Could you give us some guidance on how you plan to pay dividends going forward now that leverage is nicely under control? Free cash flow is very strong. I mean, are you planning to pay out 100% of free cash flow, or even more than that, or do you tie it to net income? How do you think about paying dividends going forward? Thank you.

Alexander Frolov:

I would probably start from your dividend question. As you know, our policy states that we intended to pay minimum $300 million of dividends per year. And then what we said, depending on the company needs or long-term strategy, including capital expenditures or level of debt or profitability, the board would decide at the end of which reporting period what sort of dividend could be distributed to the shareholders. What's happening right now, as we have mentioned in our presentation, we are quite comfortable with our level of debt. We did not expect any material reduction in the near future. We also gave you a guidance for capital expenditures and at the end of the day we don't have intention to sit on the cash. So this probably should give you a relatively clear view what sort of dividends you should expect from EVRAZ.

Then speaking about Portland. I don't think that they are prepared to give you such detailed information. As I have mentioned, even with tariff, we are making money there in Portland. But I'm not prepared to give any further details. Then speaking about split between Canadian and US markets, probably we need to take this question offline because I don't remember the split for 2017 straight away. Sorry about that.

Andrew Jones:

Okay, no worries. That was very helpful. And just one further follow-up on the working capital question. What is the reason that you expect working capital to be neutral in the second half of the year, given we've already had this large build-up in inventories and so forth of the trading companies. Would it not be logical for that to reverse in the second half or do you see it reversing in 2019? Or I mean what is the reason behind your views that working capital will be neutral in the second half?

Nikolay Ivanov:

Right, this is Nikolay. The build-up in inventory and receivables at our trading companies is primarily due to prices, okay. So if the prices will stabilise or go down, as we expect in the second half, I don't believe that it will put any more pressure on our working capital. I also should probably add a little bit, that the volumes grew also for raw materials and finished products but only at the North American division. And I believe that there will be no any further increase in volumes there because the current utilisation of assets from North America are already at a very high level.

Andrew Jones:

Okay, but if prices were to fall, you would expect a reduction in working capital logically, right?

Nikolay Ivanov:

Yeah, that's true. So if there will be a significant decrease in prices expected, yes, there might be a reduction in working capital. But we all think that it is better for the company if prices stay high.

Andrew Jones:

Yes, I would concur with that. Okay, thanks very much.

Operator:

And we'll take our next question from Vlada Novokreshchenova from Metal Bulletin. Please go ahead.

Vlada Novokreshchenova:

Hello.

Alexander Frolov:

Hello.

Vlada Novokreshchenova:

Hello, can you hear me?

Alexander Frolov:

Yes, sure.

Vlada Novokreshchenova:

So yeah. First of all, I'd like to thank you for the presentation and for the great results. And I actually have two questions. First, in your financial report, you say that EVRAZ expects steel and coal prices to decrease in the second half of 2018. So could you please tell about the reason for the potential decrease? Why do you think there will be a decrease in steel prices?

Alexander Frolov:

Sorry, and what is your second question?

Vlada Novokreshchenova:

The second question is – it's about slabs and [inaudible] sales. So in the report you mentioned that sales to the US and Europe decreased, both [inaudible 00:27:43-7] and slab. Meanwhile, they were redirected to Asia and Africa, but the report doesn't mention the exact volumes sold to Africa and America of steel products. It shows a mix of Africa, America and rest of the world so probably you have some figures in hand to say help sales to the US and Africa changed, so a year-on-year comparison.

Alexander Frolov:

So let me answer you second question. There was no significant decrease in sales of slabs to America. But we do not disclose such detailed information with regards to the volumes of sales by geographies. On the other hand, you should [inaudible] that prices for all the destinations are more or less on the same level, if let's say we deduct transportation cost and speak about [inaudible].

Vlada Novokreshchenova:

So once again price is – at the end, it is the same for Europe, America or Asia? For any destination, it's more or less the same?

Alexander Frolov:

Well, it's very similar. There might be some variation depending on specification of particular products. But not a major difference.

Vlada Novokreshchenova:

I see, thanks a lot. And for the first question about the probable decrease of prices in the second half of 2018 for steel and coal, what do you think will be the reason?

Alexander Frolov:

Look, for sure, we see at the moment some pressure on coal prices, which we believe are the same situation and most likely will return back in September and later this year. Speaking about steel, it's just a cautious statement because prices have been on quite high level already for a while. And even the local prices in China, for example, right now are improving, we still see more down-side risk than upside potential.

Vlada Novokreshchenova:

I see. Thanks a lot. So we can say it's because of overheated markets in the first half?

Alexander Frolov:

Okay, what we are saying there is potential risk of downside. We are not able to quantify that, unfortunately.

Vlada Novokreshchenova:

Okay. Thanks a lot. Thank you.

Operator:

As a reminder it is star one if you would like to ask a question. And we'll take our next question from Olga Marjasova from Evli Bank. Please go ahead.

Olga Marjasova:

Hi it's Olga Marjasova from Evli Bank. I would like to ask two questions. First one is a verification question on working capital. As of your calculation, what is your current net working capital to revenue ratio? And what is your target?

Nikolay Ivanov:

Right, our current percentage is around 8% of net working capital to the revenues, at the end of six months.

Olga Marjasova:

And what is your internal target?

Alexander Frolov:

I don't think that we are ready to disclose our internal target. We would like this ratio to be better than it is right now. But it is probably hard work to achieve any material improvement of that.

Olga Marjasova:

And currently it is 8%?

Alexander Frolov:

Yes.

Olga Marjasova:

And thank you. May I also please ask regarding a more accounting question? But if you look at your balance sheet, under long-term liabilities there is the deferred income tax liability and employee benefits. How do you treat it internally? Is it like future obligations which may arise?

Nikolay Ivanov:

Yes, that's exactly right. That's the right way to read. Yes.

Olga Marjasova:

And if to speak about, for example, rating agencies, do they treat it as debt?

Nikolay Ivanov:

I think it's a good question to ask from rating agencies. But it's not part of our –it's not viewed as part of our debt. That's for sure.

Olga Marjasova:

Okay, but when you think like internally regarding leverage do you add this numbers for the deferred income tax and employee benefits?

Nikolay Ivanov:

No, when we calculate our net debt to EBITDA ratio, we do not include those two items you mentioned. No.

Olga Marjasova:

Okay, thank you very much.

Operator:

And this concludes today’s' question and answer portion of the conference. I'd now like to turn the conference back over to our speakers for any closing or additional remarks.

Speaker:

Ladies and gentlemen, so if there are no further questions we'd like to thank you and finish this call. Good-bye.

Nikolay Ivanov:

Thank you.

Operator:

This concludes today's presentation. We thank you for your participation. You may now disconnect.

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