# EVRAZ plc

# H1 2019 financial results conference call
# 8 August 2019

## MANAGEMENT DISCUSSION

**Operator:** Please standby. Good day, and welcome to the EVRAZ H1 2019 Financial Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Alexander Frolov, CEO. Please go ahead, sir.

**Alexander Frolov:** Thank you. Good afternoon, ladies and gentlemen. Today, Nikolay Ivanov and myself are here to present our first half 2019 results.

I would like to start with health and safety this time. We are not at all satisfied with our performance this year. During the first six months, we have lost 13 lives, including eight people died in the incident with a crew bus at Raspadskaya open pit mine. We will continue our efforts to improve safety leadership by our operational managers, as well as training our employees in finding and mitigating the risks in continuously changing environment.

Speaking about our financial performance, we have delivered a set of rather healthy results. Our EBITDA reached to almost $1.5 billion, 22% decline on year-on-year terms as a result of depressed vanadium prices and lower average coking prices. Despite of this decline, free cash flow was strong and reached $692 million. As a result, our Board has decided to declare $508 million interim dividend.

As you can see from slide 8, we remain committed to our key strategic priorities, following the market trends, which, in the first half of the year, were determined by growth in steel demand and production in China; strong demand for long steel in Russia; global shortage of iron ore and metallurgical coal supply; as well as lower vanadium prices.

Our achievements during the first six months of the year are listed on the slide 9. And I will now comment on some of them. First of all, our debt has increased slightly in comparison with the end of 2018. The only reason for that was some changes in accounting standards. Net debt to EBITDA ratio remains at comfortable level of 1.1.

CAPEX in the first half of the year reached $309 million, mostly directed to maintenance projects. Major announced projects, including rail and beam mill modernization and the continuous capping machine #5 at EVRAZ NTMK, integrated flat casting and rolling complex at EVRAZ ZSMK, and long rail mill at EVRAZ Pueblo, are currently in the equipment supplier selection stage or at engineering phase. Nikolay will give you a little bit more color on CAPEX in his part of the presentation.

Now let's turn to slide 10. Efficiency improvement programs have contributed $150 million to our first half EBITDA. $111 million are linked to yields and productivity improvements, $39 million are the results of our commercial activities, primarily with the development of new products and markets.

Moving to slide 11. As I have already mentioned, our debt has increased slightly due to the accounting standard changes. On a longer-term, we remain committed to our policy not to increase net debt above $4 billion, and also to have net debt to EBITDA ratio below 2.

Our year-end outlook is presented on slide 12. We expect steel and raw material prices to be volatile. At the same time, we think that Russian steel market will remain strong and our export sales will be supported by our high level of vertical integration and superior production cost.

With that, I would ask Nikolay to continue. Thank you.

**Nikolay Ivanov:** Thank you, Alexander, and good afternoon. Please turn to slide 14. EVRAZ reported EBITDA of $1.5 billion for the first half of 2019 compared to $1.9 billion in the same period of the previous year, reflecting more challenging operating environment characterized by rising raw material costs and weaker pricing levels for our products.

A few comments on segment performance. In steel, the revenues dropped by 6%, year on year, to $4.2 billion. This decrease was mainly attributable to lower revenues from sales of steel products, which fell by 7%, year on year, due to a downturn in average sale prices, which was underpinned by unfavorable market conditions. Lower revenues from sales of steel products were partly offset by higher sales volume following the increase in production volumes at Russian mills.

EBITDA decreased due to lower prices for vanadium, semi-finished and construction products and higher prices for raw materials, including iron ore and scrap. In coal, revenues declined by 9.3%, year on year. 11.3% decline was attributed due to a slip in coal product sales prices, which was partly offset by 2.6% increase in coal product sales volumes. Coal prices followed the downward trend set by global benchmarks in the period.

EBITDA was down year-on-year amid lower coal product sales prices and higher transportation cost. Revenues from the Steel North America segment increased by 14.3%, year on year. The key growth driver was greater demand for semi-finished, railway and other steel products. EBITDA was driven by greater revenues from sales of semi-finished, railway and other steel products, partly offset by higher cost of semi-finished products and staff costs.

Moving to free cash flow on slide 15. On this slide, we present the waterfall from EBITDA to free cash flow for the first half of 2019. As you can see, our free cash flow generation remains strong at $692 million, a slight increase year on year. Net cash from operating activities climbed by 26%, year on year, to $1,175 million, reflecting a stable level of working capital.

Moving to the next slide, slide 16. EVRAZ capital expenditures increased to $309 million versus $232 million in the first six months of 2018. This increase has been driven by maintenance expenses primarily, which amounted $230 million. The largest maintenance project was a reconstruction of the blast furnace #6 at EVRAZ NTMK. Major announced projects listed on this slide are currently at the equipment supplier selection stage or the engineering phase.

Going to the next slide, slide 17. Debt management. EVRAZ began 2019 with a total debt of $4,638 million. We used our cumulative cash and part of our cash flows generated in the period to further reduce total debt and completed several transactions to extend our maturity profile. It is worth saying again that at January 1st, 2019, as a result of the application of a new accounting standard, the Group recognized $118 million of leased liabilities, which, at recognition, increased total debt.

Under the previous accounting standards, these contracts were accounted for as operating leases and were not recognized as either assets or liabilities in the Group balance sheets. These actions, together with the scheduled repayments of bank loans, reduced total debt in the first half of 2019 by $112 million. Recognition of leased liabilities under the new accounting standard also had an effect on our net debt, moving it slightly up by $79 million to $3,650 million.

Interest expense accrued in respect of loans, bonds and notes amounted to $148 million in the period, compared with $167 million in the first six months of 2018. The lower interest expense was mainly due to a gradual reduction of total debt, as well as the management's efforts to refinance existing indebtedness at more favorable terms.

Moving to dividend slide, slide #18. We are on track to continue with dividend payments and the Board of Directors yesterday recommended another interim dividend of $0.35 per share. The record date for this is August 16th and the payment date is September 5th. In the first half of 2019, EVRAZ paid over an interim dividend to its shareholders in the amount of $577 million or $0.40 per share.

To finish off this discussion, I would like to say that we view our results as rather healthy. In response to the weaker operational environment and pressures on EBITDA, we will be taking steps to improve efficiency, retain leverage metrics and support the free cash flow.

With this, I would like to thank you for listening to our presentation. And as usual, we have a few slides on our operational performance further in the presentation, which we decided not to talk through but instead give you more time for your questions. And now we are ready to your questions. Thank you.

# Q&A

**Operator:** Thank you. And if you would like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that is star one to ask a question. We'll take our first question from Dan Shaw with Morgan Stanley.

**Dan Shaw:** Hi. Thanks for the presentation. Just two questions for me. The first one on CAPEX. The first half around $300 million, guidance of $800 million. Is there some downside risk of $800 million or do you expect to see a bit of a step-up in the second half on spending? That's the first question.

Then second one, I suppose, more market focused. I mean, there's been a little bit of talk around the potential for the Russian government to spend a bit more on infrastructure. What's your assessment of these rumors, I suppose? And have you had discussions or do you have a view on whether this is something that could be quite material for this sector? Or is it too early to say? Thank you.

**Alexander Frolov:** This is Alexander Frolov. Starting from the second part of your question, I guess, that any investment in infrastructure will definitely be positive for EVRAZ business as we are exposed to construction sector. On the other hand, I guess, it's too early to make any kind of calculation how big impact or how big volume or how big increase in the market it would mean.

One thing I would probably add to that, that during this year we have seen substantial growth in Russian steel market, primarily in long products. For majority of products the growth was of the level of 10%, which is quite high number and quite good number for EVRAZ business. Speaking about CAPEX, I think our guidance for the year being $800 million remained unchanged.

**Dan Shaw:** Thank you.

**Operator:** We'll take our next question from Anna Antonova with JP Morgan.

**Anna Antonova:** Yes, hello. Thank you for the presentation and for taking the questions. Three questions from our side, I guess. For convenience, I will ask them one by one. So first, our first question is on your coal division cost. We have seen a 20% year-on-year growth in transportation cost in coal division in H1, and you commented in press release that that was due to higher mine drop volumes, transport and organization of coal storage infrastructure. Our question is, what is one-off events and cost increase? And can we expect this cost to go down and normalize to last year's levels in H2?

**Nikolay Ivanov:** So, let me refer to the slide #7 of our presentation. So, the most, I think, important thing is to look at the average cash cost for the coking coal. And as you can see here in this slide, our cash cost actually decreased relative to the first half of 2018. And the key reason for that is the high volumes, both production and sales volumes. The increase in transportation cost, if I understood your question correctly, did take place but it was not very significant and close to the inflation.

**Anna Antonova:** All right. But just a clarification on that. But compared to H1 of last year, the EBITDA margin in coal division decreased substantially. So, if the production cash cost have gone down, what would be the reason for –?

**Nikolay Ivanov:** Yeah, but that was more of a function – yeah, that's more of a function of weaker prices for coal.

**Anna Antonova:** Okay, understood. The second question from our side is, you stated that all the four major CAPEX projects are currently in equipment supplier selection stage or engineering phase. So, does this mean that they all have been approved by the Board and the go-ahead investment decision has been made for these projects with the total CAPEX of $1.3 billion? And if yes, what are your IRR estimates for each of these big four projects?

**Alexander Frolov:** First of all, we never accept any project which – where IRR is below 20%. So, it is our threshold. Speaking about major projects, typically approval is given in stages, meaning that, for example, engineering stage would be approved on the standalone and it doesn't mean that it would then lead to final approval of entire spending. Because even at the engineering stage, okay, some clarification could come and some changes, let's say, in the layout could come, which would finally lead to, I don't know, negative decision when, let's say, the decision will be presented to the Board.

So, answering your question, there is no firm commitment for $1.3 billion a year. It's all, let's say, under development.

**Anna Antonova:** Okay. Thanks for clarification. And is there any timelines for these – for example, engineering stage approvals for all these four projects, i.e. when can we expect this staged approvals over the next six months, 12 months? Or depending on the project, what's the approximate time line here?

**Alexander Frolov:** Roughly speaking, the earliest project is rail mill in United States, and for this project, engineering stage should finish by the year-end. For the other projects I think that this phase will land up in the second half of 2020.

**Anna Antonova:** Understood. Thanks. And the final question, or sort of question from our side. What can be the effect on your vanadium production and sales volumes that we can expect from the sale of flat core business?

**Alexander Frolov:** There is no impact because this facility was processed in third-party material already for quite some time and we did not recognize any revenue out of those sales.

**Anna Antonova:** Okay. Understood. Thank you very much.

**Alexander Frolov:** There will be no change.

**Anna Antonova:** Thanks.

**Operator:** We'll take our next question from Barry Ehrlich with Citi.

**Barry Ehrlich:** Yes, hello, and thank you very much. I have three questions, if I may. The first question is, how do your order books and your inputs from customers on their buying needs in the Russian market and with respect to export markets from Russian facilities compare to a year ago at this time? And what does that tell you about the sustainability of the strong end-demand conditions that you've had so far this year? And then if I may – I'll go on with the second question after you address that. Thank you.

**Alexander Frolov:** I don't think that we see any significant difference in our order book shape. No material change.

**Barry Ehrlich:** Okay. So, does that imply that the strength of the first half won't be repeated – seasonally adjusted compared to previous first halves won't be repeated in the second half?

**Alexander Frolov:** Look, I don't think that such conclusion should be made because – or could be made because length of our order book is normally equal to one – well, two months of production. So, it doesn't cover the second half of this year yet, with an exception of some products like large-diameter pipes in United States where we have much longer order book. But, again, it's not very big volume, I mean, in comparison with the total anyway.

**Barry Ehrlich:** Okay. My second question is, how did the North American EBITDA per ton see changes after the listing of 252? And maybe you can give us some comparison before and after.

**Alexander Frolov:** So, I don't think that there is any material change in EBITDA per ton. I think what's different is flow of material. So, we have been able to redirect some volumes from Canadian market to US market, which give us additional volume, not necessarily additional margin.

**Barry Ehrlich:** Okay. And finally, what would drive the decision whether there would be an interim dividend prior to March 2020? Or is that not under consideration under the current dividend policy?

**Alexander Frolov:** Our current dividend policy say that we pay dividend twice a year. And then, of course, the Board could add some payments over the top of that, depending on financial performance, which was done last year, for example. But it doesn't mean that any conclusion could be drawn down from that for the future.

**Barry Ehrlich:** Okay. Thank you very much.

**Operator:** We'll take our next question from Nikolay Sosnovskiy with Prosperity Capital Management.

**Nikolay Sosnovskiy:** Yes, hello. Thanks a lot for the presentation. I also have a couple of questions. First one is on the steel market performance in the first half. Can you please explain a little bit better, maybe in more details, regarding the construction market which is consuming so nicely? What do you think is driving demand in construction? Because of the overall economy, from what we see from Rosstat, is not doing very well. That's my first question. Thank you.

**Alexander Frolov:** I think that our understanding is that high demand is driven by construction in Moscow and Moscow region, one thing. And second thing, the reason for that is the huge change in legislation in case of residential construction with all this escrow accounts and so on and so forth. So, people are basically trying to complete all what they have in their portfolios ahead of those changes. And then we need a little bit more time to understand and to see whether or not this trend could be longer-term trend.

**Nikolay Sosnovskiy:** And just based on what you just said, if they indeed brought forward some volumes anticipating these regulation changes, do you think that could mean some below-average demand going forward when they reach their stages?

**Alexander Frolov:** As I said, it's early to say.

**Nikolay Sosnovskiy:** Yeah, okay. My second question is on safety, actually, on slide #6, there is number of fatalities in the first half of 2019, which is 13, and this is basically higher than from previous years in total for 12 months. Can you please explain what was the reason for such a hike in fatality number? Was it one accident or multiple accidents? And what the company is doing to improve this metric? Thank you.

**Alexander Frolov:** Well, as I mentioned in my presentation, we had multiple fatality at Raspadskaya open pit mine in February this year when eight people died after an accident. So, again, on one side it is one-off event. On the other hand, it's a quite tragic event. And the reasons for this event not only human factor but also, let's say, some systematic weaknesses in our operational procedures.

So, basically what we do it's just things which everyone does in the industry. We train people. We control what they do. We work a lot with the management to make sure that they pay sufficient attention to what's going on their shop floor. And also we analyze the risks and we try to mitigate them basically as much as we can. But it doesn't mean that we are perfect.

**Nikolay Sosnovskiy:** Okay, thank you.

**Alexander Frolov:** A lot should be done ahead.

**Nikolay Sosnovskiy:** Understood. And my final question. It is more of a strategic one, on your investments. I know there is a strategy in place. But can you maybe specify a little bit what would be the market condition and your earnings level, let's say, in terms of EBITDA when company and top management would start thinking of curtaining this CAPEX, maybe delaying some growth projects? So, going from the expansionary phase into more of a preservation phase. Are we there yet or how should we view this? Thank you.

**Alexander Frolov:** Well, look, as I've said before, our plans, let's say, to pursue this project, this big project further remain in place. At the same time, obviously, when we will be making substantial commitment, we will look again at market conditions and forecast available by that time. So, again, we do not invest just in order to build something new. We invest in order, let's say, to get good returns for our shareholders. So that's why we prefer to be as cautious as possible.

**Nikolay Sosnovskiy:** Thank you. All clear.

**Operator:** We'll take our next question from Boris Sinitsyn with VTB Capital.

**Boris Sinitsyn**: Hello gentlemen. Thank you for your time. I have a few questions, please. Firstly on coal division. In the press release you mentioned that like as a result of semi-soft coal prices fall, you cut or reduce output of semi-soft coal to your own operations. In this respect, what are your expectations for coking coal concentrate production for the second half compared with the first half? And how does it compare with the guidance for 2019 coal mining volumes? It is the first one.

The second one is on your turnover. In terms of inventories, we noticed some increase in first half, both versus last year and versus historical normal level for inventories in terms of days of turnover. So, in this respect what are your expectations for second half?

And the last one is on your net debt to EBITDA ratio. If you have any target in mind because actually you have – earlier in your presentation you mentioned that $1.1 billion is comfortable for you. So, is it like – do you have any upper limit for this ratio in mind? This is the last question. Thank you.

**Alexander Frolov:** Let me answer first your question about coal volumes. Basically, what has happened in July, we have reduced volumes with some third parties whom we used in open pit mining. So we just use more of our own equipment. And regarding our washing facilities, let's say, concentrate production, I do not expect any major decrease because we have certain stocks of raw coal in place. And I think those facilities will be fully loaded at year-end and because of that I do not expect any material deviation in terms of sales volumes in comparison with, how I will say, prior forecast.

` Then about turnover and net debt, Nikolay will probably answer better than me.

**Nikolay Ivanov:** Yeah, let me take the second and the third one. So, your question on turnover, yes, you're right. The inventory turnover increased slightly in the first half of 2018 relative to our historical level. That's attributable primarily to our coal division and our division in Canada. I believe it will be normalized through the year. And also let me point out that, overall, we believe that there was not any significant – well, I would say, any negative changes to our working capital.

If you look at the dynamic of our working capital for the last few reporting periods, you will see that our net – our working cap – net working capital to revenue level is at the level of 7.6%, 7.7% and that number did not change. So, we do not see a lot of issues with our working capital.

And taking your second one, yes, we are quite comfortable with the current level of net debt to EBITDA, which is just above 1. We keep saying that we do not expect that number to go above 2.0.

**Boris Sinitsyn:** Okay, thank you so much.

**Operator:** Our next question comes from Timothy Riminton with Barclays.

**Timothy Riminton:** Hi there. Thanks for your time this afternoon. So I have two questions which I'll start with first and then also third one. But start with the first two. What do you see as the outlook for sales volumes in your Russia steel division into H2? In H2 2018, sales volumes dropped off a bit. Do you expect this to happen again, or is it looking a bit firmer this year?

And secondly, you mentioned that vanadium prices have come down due to destocking and increases in production. But do you expect the market to normalize in the medium-term? What do you think the medium-term would be? And what sort of price do you estimate as a natural price in the current supply/demand environment? Thanks.

**Alexander Frolov:** Look, first of all, starting from Russian steel market. As I mentioned again before, we see this year as a stronger year to compare with 2018. And we also believe that at least third quarter of this year should be a good quarter. Now, at the same time we are not giving volume forecasts as our standard practice.

Speaking about vanadium, we see some restocking now primarily in China and basically prices went up last week to the level of $40 per kilo. Speaking about sustainable levels, longer term we believe that something around $40 could be sustainable level.

**Timothy Riminton:** Okay, thanks. And then my third question was on your Eurobond curve. You obviously issued the 2024s earlier this year at a pretty good price. The market now is indicating potential for even better prices for you. Do you – have you had any thoughts about refinancing some of your other Eurobonds and taking advantage of the conducive market conditions?

**Nikolay Ivanov:** So, first of all, let me say that we have placed ruble bonds just recently, just actually a week ago. And the amount of this bond issue – it was ruble-denominated bonds. The amount of this issue was RUB20 billion, which is slightly more than $300 million. We are planning to use the proceeds from these bonds to refinance the more expensive bank debt. Speaking about any other potential issues of bonds, you shall take into account that if you look at our debt maturity profile, the total amount that we need to repay in the next 18 months is below $50 million.

At the same time, we are always monitoring the markets. And if the market will remain strong, I cannot guarantee, I cannot say but we might consider another issuance to re-finance the bonds.

**Timothy Riminton:** Great. Thanks very much.

**Operator:** And as a reminder, that is star one to ask a question. Our next question comes from Andrew Jones with WOOD & Company.

**Andrew Jones:** Hi gents. Just a question on dividends. On one of the previous calls recently, you've said that you're comfortable with your level of net debt and you didn't really want to reduce it further, which implies to me that you were looking to payout 100% of free cash flow going forward, in line with some of your peers. That wasn't the case in the first half. Could you give us some color on what your intentions are for dividends for the full year this year relative to free cash flow? Should it be – should we be modeling it in line or slightly lower, like how – can you give us some idea about dividend expectations this year? That's my first question. Thank you.

**Alexander Frolov:** Look, what we have been telling before, we have commitment for the minimum dividend payout. And if the Board decides to pay more, decision would be based on consideration of financial performance of the company, first saying, but also future needs of the company. And, for example, what we are doing now, as you mentioned yourself, we are not going to increase net debt. At the same time, we expect more CAPEX for the second half of 2019 and we expect, in general, more volatile market in the second half in comparison with the first half. So, that's why, I guess, the Board made prudent decision to pay as much as you have seen.

**Andrew Jones:** Understood. Thank you. And just on some additional guidance for the second half for the year, what sort of dynamics are you expecting in terms of your cost base going forward in the second half? I mean, on the coal side you're not expecting a decrease in volumes. I mean, do you expect similar costs there in the second half? And in the steel division, what sort of dynamics do you expect there? I mean, we can see that iron ores had gone off. It's now falling, coal is falling. I mean, what – could you give us some idea of your expectations for how cash cost might develop in the second half?

And also in North America, there's been a big jump in the EBITDA per ton. Is that sustainable going into the second half? Or what sort of moving parts do you expect to impact on EBITDA on the North American divisions in 2H? Thank you.

**Alexander Frolov:** Look, normally we do not give any forecast about our future financials, and I guess, in case of North America, it would be a little difficult to do that because we are working in different segments and different geographies.

Talking about Russian assets, coal and steel, I don't think that we expect any big changes in the cost just because of our vertical integration.

**Andrew Jones:** Okay, thank you.

**Operator:** We'll take our next question from Janna Anikina with BCP Securities.

**Janna Anikina:** Hi. Thank you for taking the call or question. Question about EBITDA. According to your presentation it was affected by rising raw material prices, specifically iron ore. Could you please remind us what's your self-sufficiency in iron or? And you basically count into your cost at market prices; is that correct?

**Nikolay Ivanov:** Yes, speaking about our self-sufficiency, we are fully covered in Europe[?] division, so it's NTMK with respect to the iron ore, so we are 100% self-sufficient. Speaking about our Siberian assets, our self-sufficiency is approximately 60%.

**Janna Anikina:** So, basically – but in all cost calculations you input your own iron ore and whatever you're buying from third parties at market prices. Is that basically correct?

**Nikolay Ivanov:** When we calculate the cash cost for the steel, yes, we use market prices.

**Janna Anikina:** Okay. Thank you for clarifying. And you mentioned that you are expecting CAPEX to increase going into the second half of the year. Could you please break it down what's for maintenance and why there is an uptick in that? Thank you.

**Nikolay Ivanov:** First of all, yes, there will be an increase in the CAPEX. So, our guidance for the year 2019 is around $800 million. So, we're talking about spending around $500 million. I would say that the majority of that will be still in the area of the maintenance CAPEX, with the increase in development CAPEX as well as we speed up with the new project.

**Janna Anikina:** Thank you so much.

**Operator:** And once again, as a reminder that is star one to ask a question.

**Irina Bakhturina:** Ladies and gentlemen, we see that there are no further questions. We would like to thank you for this call today and have a nice day.

**Alexander Frolov:** Thank you.

**Nikolay Ivanov:** Thank you.

**Operator:** And that does conclude today's conference. We thank you for your participation. You may now disconnect.

# Disclaimer

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