EVRAZ plc

H1 2020 financial results conference call
6 August 2020

MANAGEMENT DISCUSSION

OPERATOR: Good day, and welcome to the EVRAZ H1 2020 Financial Results Conference Call. Today's conference is being recorded.

At this time, I'd like to turn the conference over to Alexander Frolov, CEO. Please go ahead, sir.

ALEXANDER FROLOV: Thank you. Good evening, ladies and gentlemen. Today, during this Nikolay Ivanov and myself would like to share with you our results for the first half of 2020.

Thanks to the efforts of management and employees, for we succeeded to steer for the difficult period without major disruptions or negative consequences. We believe that from now on the business environment will be more stable.

Now let's move to the slides. Slide 5 shows key highlights that we will be discussing during our presentation today. First of all, COVID-19 spread worldwide has impacted steel and raw materials markets very strongly. Despite of this turbulence, EVRAZ was able to achieve EBITDA for almost $1.1 billion. EBITDA margin declined year-on-year, but still stay at (inaudible) level of 21.5%, partly due to our cost-cutting initiatives and customer focus efforts contributing $251 million to EBITDA.

CapEx amounted to $333 million, and our free cash flow remained positive and reached $315 million. Net debt slightly increased but only to $3.7 billion.

Based on these positive results, the Board of Directors decided to recommend an interim dividend for 2020 of $0.20 per share, totaling $291 million.

Slide 6 shows our safety performance. In the first half of 2020, we have recorded 0 fatalities. This result made us even more convinced that our attention to risk identification and mitigation should be even more rigorous than before. Slide 7 provides a detailed COVID-19 impact update. I believe that EVRAZ was acting on this challenge very proactively and ahead of time. Already as of the end of March, we have introduced all necessary measures to ensure safety of our employees and continuation of our operations. We still continue to monitor the situation very closely to make sure that we are prepared for any negative development. Our strategic priorities shown on Slide 8 did not change. Low-cost position, customer relations, prudent CapEx and careful debt management combined with stable dividends. All remain in place. The next few slides are dedicated to these priorities, and then will go scroll down one by one.

On Slide 9, you can see that we remain committed to our vertically integrated business model, which allow us to retain a low-cost position even during turbulent market environment.

Let's move to Slide 10. Our efficiency improvement program generated $83 million of EBITDA, so productivity growth and yield improvements. Our customer focus initiatives added another $168 million as a result of sales and efforts in wheels and grinding balls and also some improvements in logistics and supply chain. On Slide 11, I would like to say a few words about our CapEx and our investment and development. In 2019, EVRAZ announced an investment program with total amount annual CapEx averaging $1 billion over 2020 to 2023. In the second quarter of 2020, given the worsening on economic conditions in Russia and globally. The management reprioritized several key development projects. The decision was made to postpone execution of the rail and the mill modernization project in EVRAZ NTMK and execution of integrated flat casting in rolling facility project in EVRAZ ZSMK. In North America, Pueblo, a new long rail mill project continued according to the schedule. And in June, the Board of Directors approved the start of the execution phase of this project. As a result, our 2020 target for CapEx will be about $800 million.

As you can see on Slide 12, EVRAZ ended the first half of 2020 with net debt of $3.7 billion. It's only $83 million increase in comparison with the end of 2019, and we remain committed to keep our net debt below $4 billion. In the reporting period, EVRAZ has already paid $581 million of dividends. Based on positive first half results and stable debt position, EVRAZ Board of Directors, as I said earlier, declared another interim dividend of $0.20 per share or $291 million (inaudible).

So let's move to Slide 13. Our view is that the second half of 2020 could be still quite challenging due to global economy decline. In view of this, we will put all necessary efforts to sustain production at full capacity and maximize our sales in the Russian market. But we also focus on additional efficiency improvement measures. And we'll maintain balanced and selective approach to our investment projects.

With this, I would like to pass the word to Nikolay. Thank you. Nikolay, please.

NIKOLAY IVANOV: Yes. Thank you, Alexander. Good afternoon. So let's go straight to Slide #15 of the presentation. In the first half of 2020, we reported EBITDA of almost $1.1 billion compared to $1.5 billion in the first 6 months of the last year. The decline was largely driven by lower steel, vanadium and and coal product sales prices, as well as lower sales of tubular and flat-rolled steel products resulting from weakening market demand in North America. A few comments on segment performance. In steel segment of our business, revenues dropped by 17.5% year-on-year to $3.4 billion. EBITDA amounted $900 million. The drop in EBITDA was due to lower prices for vanadium construction and other steel products, partially offset by lower cost of sales as well as the effect of the ruble depreciation. For steel North America segment, revenues decreased by 21.8% year-on-year to [$1 billion]. The key drivers were weaker demand across product segments and softer market demand as customers managed inventory levels. EBITDA decreased due to lower revenues from sales of flat-rolled, tubular, railway and construction products. In coal segment, revenues fell by almost 30% year-on-year to $800 million. Mainly due to a decline in coal product sales prices by 29.8% and a decrease of 0.9% in coal product sales growth. EBITDA was down year-on-year, and its lower coal product sales prices. (inaudible) despite a market to deliver positive free cash flow of $315 million for the period. Free cash flow generation was supported by a small working capital release. Moving to the next slide, Slide 17. In the first half of 2020, management focused on liquidity and preparations to refinancing of capital market maturities coming due in the first quarter of 2021. In March, we signed a $750 million committed syndicated facility with a group of international banks with availability period till March 2021. In addition, we decided to increase cash safety cushion through utilization of RUB 28 billion under existing committed and uncommitted credit lines with VTB. As of June 30, 2020, our total debt increased by $229 million and reached $5.1 billion.

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The net debt increased by $288 million to $3.7 billion, as Alexander has mentioned already. [First] expense during the period remained flat year-on-year at the level of (inaudible) $47 million.

Management's efforts to refinancing debt on more favorable terms resulted in stable interest expense despite the higher total debt loan. As of June 30, 2020, cash amounted to almost $1.4 billion, while short-term loans and the current portion of long-term loans amounted to only $1.1 billion. Cash balances and committed credit facilities available to us comfortably cover upcoming debt maturities. Moving

to Slide 18. As was said already, yesterday, the Board approved an interim dividend for 2020 is a total amount of $291 million or $0.20 per share, which will be paid on the second of October 2020.

With this, I would like to thank you for listening to our presentation. As usual, we have a few slides on operational performance, but I will not talk through them, but instead give you more time for your questions. Now we are ready to take your questions. Thank you.

Q&A

OPERATOR: (Operator Instructions) Our first question comes from Anna Antonova of JPMorgan.

ANNA ANTONOVA: Congratulations on pretty good results for the first half. A couple of questions from my side. First, on Slide 10, on your $83 million cost-cutting measures that you have achieved in the first half. Could you please specify how much of that number is sustainable going forward? I believe that, for example, improving yields are, but any other components? And that's the first question.

ALEXANDER FROLOV: Okay. So it Alexander. I think that our methodology assumes that we take consideration into consideration all the improvements, which are sustainable. We are not including any one-offs into those numbers.

ANNA ANTONOVA: Okay. So just to be clear, these cost savings do not include any FX effects of recoverable or the market...

ALEXANDER FROLOV: No, no, no. Nothing like that, only, let's say, better yields what (inaudible) high utilization over current month, which is sustainable and this kind of things.

ANNA ANTONOVA: And the second question is on your postponed projects at EVRAZ ZSMK and NTMK. Could you please maybe provide some more comments around this decision? And what factors can potentially trigger or make you review these projects and make a (inaudible) decision?

ALEXANDER FROLOV: Well, look, I think that we should differentiate these 2 projects. And we think that for example, project in (inaudible) has sufficient chances to be restarted within, let's say, a relatively short period of time. I mean, next year or year after. Continuous casting and rolling facility in ZSMK. From the very beginning, we had an understanding that it contains certain market risk. It was assumed that market in Russia will grow especially in flat segment. And on the current conditions, we believe that because of current decline and some uncertainty in restoration of the market. It would take longer time when those marketing risk would again become acceptable for us. And they could happen whatever, within 2 years, 3 years from now, it is difficult to say at the moment.

ANNA ANTONOVA: Very clear. And the other question is on purchase of POSCO shares. Could you please specify what is your current shareholding POSCO? And what the strategic rationale, if any, behind the recent buybacks of POSCO shares?

ALEXANDER FROLOV: So I probably do not remember exact number, but current shareholder -- shareholding is above 90%. And again, we believe that this is a good business, under-valued at the moment. And it was optimistic purchase, one price was whatever (inaudible) we were buy because we believe that intrinsic value is high.

ANNA ANTONOVA: And could you please comment more about your outlook for the domestic steel construction market and coal markets for the remainder of the year. With conditions, price trends, we can see that the domestic steel prices to both flat and long steel are gradually creeping up in ruble terms. But what are your current expectations on heading into fall and into winter season? Do you expect seasonal decline in prices and in-demand in Q4 or this year with the first half being disturbed by COVID trends, would you expect the construction still demand to hold and somehow gradual seasonality is very weak Q4, what's higher thoughts on this? And on the coal market as well? So your peers guide that in domestic coal markets remain an oversupply into the year-end, at least what I know it is on the core markets here.

ALEXANDER FROLOV: Okay. Thank you. I guess you partly gave the answer. I mean, when you were describing the situation in such detail. Domestic steel market obviously has declined or due to the, let's say, call it situation and whatever slowdowns and the shutdown of construction for some period of time. So -- and you can see the numbers in our presentation, it's roughly a 10% decline for most of construction products we sell. At the moment, however, we see demand for July and August, very, very close to the last year volume. At the same time, because of all this seasonality, it's difficult to predict what will happen in Q4. Again, we will see with time, let's say, where the market would go. But typically, it is some slowdown during this period of time. And I guess, overall market in 2020 will look bit better than it was last year, for sure.

Then talking about coal. I believe that the domestic prices would probably remain under pressure because, so let's see, international prices historically low. Logistic restrictions to ship coal from Kuzbass, for example and to export it, still remain in place. So again, unless there would be a significant pickup in international prices, I do not expect that domestic market would demonstrate any positive (inaudible).

ANNA ANTONOVA: And then one final question, a follow-up basically on the market outlook. So you're steel sales in the Russian division were up by, I think, 4% in the first half. What can we expect for the full year versus the base of last year? Does it -- in view of current trends, does it seem reasonable to assume that steel sales level can be below or above last year's? And the same question, I guess, for a coal, where basic coal sales volumes of this year versus last year?

ALEXANDER FROLOV: Again, it's difficult to make forecast for the full year, I would not do so.

Again, situation still remains quite uncertain.

OPERATOR: (Operator Instructions) Our next question comes from Timothy Riminton of Barclays.

TIMOTHY RIMINTON: So on your your plans around debt refinancing? And correctly from what you said, the facility -- the syndicated facility that you signed for $750 million is specifically for the refinancing of the 2021 bonds, does that mean that you're not going to look at refinancing in capital markets? And then, if that is the case, I'm just wondering how you're thinking about your financing structure? As previously, you've sort of had about 60%, 70% capital market debt and the rest net debt and this would obviously shift that more towards bank debt looking ahead?

ALEXANDER FROLOV: Nikolay?

NIKOLAY IVANOV: Yes, yes. Thank you. You're correct, and thank you for the question. So we will be paying approximately $1 billion. If you look at our maturity table, around $1 billion of debt in the first quarter of 2021. In March of this year, we signed a $750 million facility. It's a committed syndicated facility with a group of international banks and the funds will be available for 1 year after signing. So we are currently planning to utilize this whole amount to repay most of our debt in the first quarter of 2021. But again, we are not obligated to do this. This is just our current intention. And from this facility, nothing is utilized at this moment.

Answering your second question, you are correct that our debt structure was approximately 66% to 33% with regards to the capital that versus bank debt. But again, we are not restricted to any structure of that. We might change it. It's our own discretion. And the bank debt might increase slightly in the future in our share of the total debt.

TIMOTHY RIMINTON: Okay. And can you make any comment on how you -- like, is the bank debt on more favorable terms than you think you'd be able to get in international markets at the moment?

NIKOLAY IVANOV: Yes. Actually, what -- all our debt strategy is around bowing on a more variable charge. So if the bank debt is cheaper, we will go for that.

OPERATOR: Our next question comes from Ilya Dmitriev of Goldman Sachs.

ILYA DMITRIEV: So I have a question on the efficiency program and the customer focus initiatives. So these initiatives added roughly $250 million to EBITDA in the first half of the year. So what do you expect to see in the second half?

ALEXANDER FROLOV: Well, look, the simple answer is that our plan for this year was in excess of $300 million total and are seeing that track is good. I mean, we are carefully looking at all, let's say, initiatives we have there. It's a big number of initiatives. Of course, some of them did not fly because lower demand in the market. At the same time, on cost side, everything goes well, and we are also finding another, let's say, ways to get cost improvement, I mean, which we did not foresee in when we were planning 2020.

ILYA DMITRIEV: Understood and second question, so you [constantly] mentioned intention to keep the net debt-to-EBITDA below 2x. So what will happen if you see this level? So will you cut CapEx or dividends?

ALEXANDER FROLOV: Well, we don't plan to cut dividends, to start from that point. As you know, let's say, our dividend policy allow us certain flexibility. So we are committed to minimum dividends of $300 million per year payable twice whatever 152 [times]. And then, of course, if we will see that in order as to maintain that level. We have to post on other development projects before completion of Pueblo one, we will do so, yes, for sure.

OPERATOR: (Operator Instructions) The next question comes from Alexey Kirichok of Sberbank.

ALEXEY KIRICHOK: It's Alexi from Sberbank. I have 3 questions. So the first one is, you stopped semi-hard coking coal mine in the Raspadskaya open pit and coking coal mining at (inaudible) in Raspadskaya towards international benchmark price levels, can you consider results in these operations.

ALEXANDER FROLOV: Shall we go one by one? Or you ask all 3?

ALEXEY KIRICHOK: Yes, yes. One by one.

ALEXANDER FROLOV: Again, I would say that, roughly speaking, that today, hard coking coal is below [$110], which is historically low. I would say, if we see it at whatever [$130], for some period of time, making sure that it's not a short-term trend. Yes, we will start Raspadskaya open pit. Talking about (inaudible) in Raspadskaya, there are no plans to restore that. It was our strategic, let's say, goal to reduce number of (inaudible) walls Raspadskaya from 3 down to 2. And we just did that. It was not so much driven by market conditions. It was a gradual development of existing, let's say, whatever confit.

ALEXEY KIRICHOK: Clear. So the second question, could you please provide more color on the current demand for construction, high value-added products in the second half of 2020? Do you see it over the close to last year's levels? Or is it lagging demand for rebars and other non-HVA finished business?

ALEXANDER FROLOV: Well, look, first of all, we started with high-margin and (inaudible), unfortunately, are not high-margin and obviously, difficult to predict because there is a lot of competition, a lot of competition there. And for us, it's not important because we can always switch, let's say, from rebar to semi-finished, talking about better products like [GBMS], large beams and profiles, we see that current demand is good. It has improved over the last whatever month or so. And we also put a lot of efforts to increase our sales of (inaudible), for example, by replacing welding structures which are widely used anyway, and volumes there is much bigger than volume on a base well. So we see some opportunities there, and we are working on them, and we believe that this will actually support our sales (inaudible). If we are good enough there, we might even exceed last year. But again, it's too early to say.

ALEXEY KIRICHOK: And the final question, could you please provide any outlook for the rail demand for the next year for domestic rail demand?

ALEXANDER FROLOV: Well, look, you know that major consumer is Russian Railways. So it's better to ask them than ourselves. My understanding is that they don't have any plans to cut the maintenance and investment programs. No, I did not hear anything like this.

OPERATOR: At this time, we have no further questions in queue. (Operator Instructions) There are no further questions.

IRINA BAKHTURINA: Yes. I think, yes, we see that we have no further questions. And I would like to thank everyone for joining our conference call today and for your questions. With this, I think we will finish the call. Have a good day. And thanks again. Bye-bye.

ALEXANDER FROLOV: Thank you.

NIKOLAY IVANOV: Thank you.

OPERATOR: Thank you. Ladies and gentlemen, this concludes today's teleconference. You may now disconnect.

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