EVRAZ

H1 2014 FINANCIAL RESULTS

Transcript of the conference call

Corporate participants:

- Alexander Frolov, CEO
- Giacomo Baizini, CFO
- Pavel Tatyanin, Senior Vice President and Head of International Business

Management presentation

Operator

Ladies and gentlemen, thank you for standing by and welcome to EVRAZ plc H1 2014 financial results. At this time all participants are in the listen-only mode. There will be a presentation followed by a Q&A session, at which time if you wish to ask a question, you will need to press “*1” on your telephone. Alternatively, web participants may submit a question at any time by typing it in the *Ask a question* box and clicking *Submit*. I must advise you today’s conference is being recorded, Wednesday, 27 August 2014. I would now like to hand over to your speaker today, Alexander Frolov, CEO. Please, go ahead.

Alexander Frolov

Thank you very much. Ladies and gentlemen, I welcome you to our conference call to discuss the financial and operating results of EVRAZ for the first six months of 2014. I hope you have had an opportunity to download the Company’s presentation, which is available on our website. I would like to remind everyone that the matters discussed on this call will include forward-looking statements that are subject to many factors, risks and uncertainties that are described in detail on the second page of the presentation. We undertake no obligation to update any forward-looking statements.

The situation in the steel sector remains challenging. The global steel industry has continued to deal with excess capacity, which keeps margins under pressure. In response to this challenging environment, EVRAZ’s board and management have adjusted certain corporate priorities and in line with the Company’s long-term strategy implemented changes designed to maintain competitiveness. We believe that we are beginning to see a clear positive result from our efforts. During the reporting period we delivered successfully against the targets, operation plans and cost reduction programmes announced at the time of our 2013 FY results. Our operating strategy is aimed at building on our core value drivers: the economically efficient low-cost production of steel making raw materials, iron ore and cooking coal, our high-quality steel assets in attractive markets, and the Company’s competitive product portfolio, encompassing an increasing range of higher value-added products. In line with our strategy, we are committed to four strategic priorities: cost-cutting initiatives, selective investment in low-risk high-return projects, customer focus to leverage our leading market positions, and deleveraging. You will have read some of our progress in respect of the priorities in the interim results announcement published this morning. We are going to elaborate on some of them in today's presentation.

You will find the agenda for today's presentation on page 2. Now please turn to page 4. Enhancing health and safety conditions remained the key objective. It is with deep regret that I have to report that 7 employees and 6 contractors lost their lives in work-related incidents during the first six months of 2014. Any fatality is unacceptable to myself and to all of the management team. We investigated the causes of all the accidents and ensure that corrective measures are taken. Unsafe behaviour on the part of our employees and contractors accounts for approximately 90% of the accidents. Our priority is to change the attitude and behaviour particularly within our CIS facilities. And now I am handing over to our CFO, Giacomo Baizini, for the detailed analysis of H1 2014 results.

Giacomo Baizini
Thank you, Alexander. Good afternoon, ladies and gentlemen. We will begin with an overview of our performance in H1 2014, so please turn to slide 5. The volume of steel sales for H1 2014 amounted to 7.7 mt, revenue experienced a 7% decline to US$ 6,805m compared to H1 2013, a decrease which primarily reflects lower selling prices as a result of overcapacity in the global steel industry. EBITDA totalled US$1,080m in H1 2014 compared to US$925m for the corresponding period of 2013. This 17% increase largely reflects actions taken by the Company in terms of asset optimisation and implementation of cost efficiencies. The strong free cash flow performance of US$444m for H1 2014 allowed us to decrease net debt to US$6,095m as at 30 June 2014. Our net leverage consequently declined from 3.6x at the year end to 3.1x, thereby strengthening the Company's financial position.

Turning to slide 6, you will see the Group revenues for the period decreased by 7% to US$6,805m with revenues from the Group's steel segment amounting to US$5,898m or 80% of total Group revenues. The decline in revenues was largely due to decrease in prices in line with the general negative trend in steel pricing as well as the lag of domestic steel price in Russia and Ukraine and adjusting to the depreciation of the local currencies versus the US dollar that occurred in H1 2014. Steel revenues were also impacted by changes in the Group's product mix during 2013–2014 due to the suspension of operations of EVRAZ Claymont Steel and EVRAZ Palini e Bertoli, the EVRAZ Vitkovice Steel disposal and closure of the plate mill at EVRAZ ZSMK. While sales volumes of flat-rolled steel products declined, a part of semi-finished production was switched from internal consumption to external sales. Lower sales volumes of flat-rolled steel products were partially offset by higher sales of railway and tubular products. Overall, the changes in sales mix contributed to a 1% decrease in revenues. Iron ore revenues decreased by 26.8% to US$659m in the period, primarily due to the disposal of a number of Evrazruda's iron ore mining and processing facilities as well as the disposal of VGOK. The Group's EBITDA increased by 17% to US$1,080m in the period, from US$925m in H1 2013, as a result of our asset optimisation programme and the implementation of cost efficiencies. The Steel segment EBITDA in H1 2014 is higher than in H1 2013 as a result of these factors, as well as the decrease in expenses in US dollar terms at the Russian and Ukrainian subsidiaries due to the local currencies depreciation in H1 2014. Lower prices for coking coal and iron ore also impacted positively the segment's results. In addition, the Steel segment EBITDA was influenced by the better performance of EVRAZ's North American assets. The economy on the cost side was partially offset by decline in steel products sales prices and the lag in price adjustment in Russia and Ukraine following the currency depreciation. The higher Coal segment EBITDA was related to the decrease in costs associated with the Russian rouble weakening, portfolio optimisation at Yuzhkuzbassugol, operational improvements, and the increase in sales volumes of coking and steam coal. The Iron ore segment EBITDA was negatively impacted by falling prices for iron ore products, which were partially compensated by decrease in costs.

Now please turn to page 7 for a look at EVRAZ's consolidated costs. The Group's cost of revenue decreased by 12% compared to H1 2013. This was mostly due to a fall in staff costs, auxiliary materials, semi-finished products, depreciation charges, transportation and raw materials costs. The cost of raw materials, our largest single cost item, decreased by US$88m, driven mostly by a combination of lower coal and scrap prices as well as the shutdown of EVRAZ Claymont, which consumed purchased scrap for steelmaking in H1 2013. This decrease was partially offset by an increase in iron ore costs due to lower intra-group sales resulting from the disposals and shutdowns of certain iron ore assets in 2013. EVRAZ has also implemented operational improvements that resulted in the optimisation of yields at the Russian steel mills and also helped to decrease the cost of raw materials. The costs for semi-finished products fell by 56% primarily due to lower consumption of slab purchased from third parties by EVRAZ North America's assets, which were substituted by shipments from the EVRAZ NTMK mill in Russia. The transportation services decreased by 22% related to the Russian rouble weakening and a slight decrease in production volumes, on one hand, and tariffs increase, on the other. Staff costs decreased by 14%, or US$137m, reflecting the impact of factors including the local currency weakness in Russia and Ukraine, the disposal and optimisation of assets, and our personnel optimisation programmes. Total depreciation, depletion and amortisation in cost of goods sold decreased by 22% against H1 2013. The depletion charge was significantly reduced in the Coal segment driven by Yuzhkuzbassugol due to the revision and detailing of future mining plans and lower mineral deposits depletion. In addition, the remaining useful lives of plant and equipment were reassessed and extended at EVRAZ's Russian and Ukrainian steel mills. Again, this was accompanied by a decrease of the US dollar amount of depreciation at our Russian and Ukrainian sites due to the local currencies weakening.

And now please turn to slide 8. Last year we initiated a number of operating efficiency and cost cutting programmes. The plan provided for staff optimisation, including a headcount reduction and related G&A costs, reduced coal and iron ore mining costs and operation improvements, such as improving yields in both raw material and conversion costs, in our steel mills. As you can see, the cost cutting initiatives at our ongoing operations yielded total savings of approximately US$98m. The optimisation of the Company's asset portfolio, shutdown and disposal of unprofitable or non-core operations in both steel and mining led to a further US$59m effect. In addition, the increase in production at both EVRAZ North America and the Raspadskaya mine contributed another US$36m. On the whole, the implementation of the efficiency improvement plan resulted in a US$193m improvement in H1 2014, broadly in line with the full year target of US$400m.

Turning to slide 9, you see the free cash flow for the period was positive at US$444m due to improved business performance, but also as a result of the disposal of EVRAZ Vitkovice Steel. US$90.4m of the disposal proceeds were paid out in dividends in July, but the rest has been retained to reduce debt. You can see the calculation of US$444m in the chart. Cash flows from operating activities before changes in the working capital increased by 31% to US$970m, reflecting better operational results compared to H1 2013. In H1 2014, the US$126m outflow in working capital was mainly related to the repayment of a US$312m payable to Yuzhny GOK, a supplier of sinter to EVRAZ DMZ in Ukraine. CAPEX reduced to US$365m from US$492m as a result of the ongoing CAPEX optimisation programme. Proceeds from disposals, mainly EVRAZ Vitkovice Steel, amounted to US$296m.

Now please turn to slide 11 for our debt bridge and net leverage. As you can see on the slide, we started 2014 with a total debt of US$8,166m and net debt of US$6,534m. By 30 June 2014, our total debt decreased by almost US$700m to US$7,479m. As previously mentioned, our net debt decreased by 7% to US$6,095m, meaning that net leverage decreased from 3.6x to 3.1x. This put the Company in an increasingly secure financial position.

If you now turn to page 12, you can see that during the period we repaid short-term lines totalling US$1 bn, part of which was subsequently redrawn. In January 2014, we borrowed US$70m under a US Ex-Im guaranteed facility to refinance part of the EVRAZ ZSMK rail mill CAPEX. All of these, together with a number of minor scheduled repayments, resulted in a decrease of debt. Cash and short-term deposits as at 30 June 2014 amounted to US$1,353m, compared to the short-term debt of US$1,244m. After the reporting period, on 12 August 2014, we signed a US$425m 5-year syndicated pre-export financing facility, which now covers most refinancing needs until Q4 2015.

We look now at the business by regions, so please turn to slide 14. EVRAZ’s Russian operations were the major contributor to the consolidated EBITDA, generating US$1 bn, 15% more than in H1 2013. EVRAZ North America EBITDA was also strong, US$129m, increasing 59% compared to H1 2013. In addition, EVRAZ Ukraine improved its performance to US$53m of EBITDA compared to US$40m for the same period last year. EBITDA of EVRAZ South African operations was a negative US$12m due to the weak economic environment in the region.

On slide 15 you will see the results of our Russian and Ukrainian steel operations. In general, EVRAZ’s Russian steel making facilities continued to operate at a high utilisation rate, which was close to full capacity. Steel products sales volumes increased by 6%, mostly as a result of higher sales of semi-finished products, driven largely by changes in the product mix. As previously mentioned, steel revenues were also impacted by changes in the Group’s product mix. Sales volumes of construction products were broadly stable despite growing competition from other Russian producers, with revenues impacted by lower prices. Sales of railway goods increased due to sales of rails, up to 530 kt in the period compared to 390 kt in H1 2013. The rail mill at EVRAZ ZSMK is gradually ramping up the rail output after the completion of the modernisation programme, and in H1 2014 we commenced shipments to Russian Railways of 100-metre rails. The average cash cost of slabs decreased to US$292 per tonne from US$369 y-o-y.

Turning now to page 16, you will see that EVRAZ North America's steel assets performed well, backed by an improving economic environment and outlook. The total sales volumes were broadly stable, and revenues increased by 5%, driven by higher sales of rails and tubular goods. Suspension of the unprofitable EVRAZ Claymont operations resulted in a decrease in sales volumes of flat-rolled products, but improved the profitability of the flat-rolled division. The performance of the tubular products group benefited from the oil and gas renaissance in North America, promising market fundamentals in the large-diameter pipe business, as well as operational improvements at EVRAZ's pipe mills. The overall volumes of tubular products grew by 22%. As a result of the successful completion of the rail mill modernisation and steel making upgrade projects at EVRAZ Pueblo, rail sales increased by 21%, supported by strong demand and good customer relations.

Please turn now to page 17 for some results of our coal business. The total coal sales volumes increased by 17%. External sales grew by 41%, driven by production ramp-up at Yuzhkuzbassugol's Yerunakovskaya-VIII mine and the Raspadskaya mine, as well as higher sales of steam coal, produced by the Kusheyakovskaya mine, which was not operational in Q1 2013. However, the performance of our Coal segment in H1 2014 was negatively impacted by lower prices in line with global price trends, which offset the increase in volumes. Blended cash costs decreased to US$55 per tonne of coking coal concentrate in H1 2014, compared to US$ 66 per tonne in H1 2013 and US$63 per tonne in H2 2013. The growth of coal production both at Yuzhkuzbassugol and Raspadskaya as well as the mine portfolio optimisation programme contributed to the reduction of coal concentrate cash costs.

Please now turn to page 18. Iron ore segment revenues decreased by 27% to US$659m in H1 2014, compared to US$900m in H1 2013, due to lower sales volumes for internal consumption as a result of the disposal of EVRAZ VGOK and the optimisation of Evrazruda's assets. This decrease in sales volumes was accompanied by lower iron ore prices. During the period, approximately 77% of EVRAZ's iron ore consumption was satisfied by the Group's own operations, compared to 95% in H1 2013, predominantly due to the disposal of assets in the Iron ore segment. Cash costs for iron ore products calculated for Fe content of 58% decreased from US$66 per tonne in H1 2013 to US$52 per tonne in H1 2014 mainly as a result of the disposal of high-cost operations.

Turning now to page 20, we can review CAPEX. With a number of major capital-intensive projects now successfully completed, we will focus on low CAPEX and fast payback efficiency projects, which have a projected internal rate of return of at least 40%. We have already announced projected CAPEX spending of a maximum of US$900m for each of the years 2014 and 2015. In H1 2014, CAPEX amounted to US$365m, which is in line with this plan.

To summarise then, on page 23, despite the challenges of the current environment and a number of developments across the Group during the period, sales volumes were broadly flat, and the financial results reflected weaker steel and steel raw materials price environment. We recorded an EBITDA of US$1,080m, and an EBITDA margin of 15.9%. Our asset optimisation and cost efficiency actions achieved US$193m of gains, and our CAPEX of US$365m is in line with the cap on annual CAPEX of US$900m. Once again, we are committed to developing CAPEX spending only on projects with a high IRR. Lastly, the Company's deleveraging programme is on track to reaching net debt to EBITDA ratio of less than 3x. Thank you very much for listening to our presentation, we are now ready to take your questions, but, as ever, I would also draw your attention to the additional information which we have compiled in the Appendices.