EVRAZ H1 2013 results

Transcript of the conference call

Corporate Participants

Alexander Frolov
Giacomo Baizini
Pavel Tatyanin

Management Presentation

Operator

Thank you for standing by and welcome to the EVRAZ H1 2013 financial results conference call. At this time all participants are in a listen-only mode. There will be a presentation followed by question and answer session at which time, if you wish to ask a question, you will need to press * 1 on your telephone. I must advise you that this conference is being recorded today, on Thursday 29th August, 2013. Let me hand the conference over to your speaker today, Alexander Frolov, CEO, Giacomo Baizini, CFO and Pavel Tatyanin, senior vice-president, international business. Over to you, gentlemen.

Alexander Frolov

Thank you very much. Dear ladies and gentlemen, I would like to welcome you to our conference call to discuss the financial and operating results of EVRAZ plc for the first half of 2013. I hope you have taken the opportunity to download the webcast presentation which is available on our website, EVRAZ.com as we will be following it during the call. Traditionally, before I begin I would like to remind everyone that the 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 first half of 2013 was challenging for the steel industry. While our sales were broadly flat, the financial results inevitably reflect the weaker steel price environment with revenues and EBITDA decreasing versus the first half of 2012. However, during the reporting period we successfully delivered on three key investment projects; the commissioning of the new coke and coal mine, Yerunakovskaya VIII, the launch of a modernised rail mill in the EVRAZ ZSMK and the introduction of PCI technology at the EVRAZ NTMK. Each of these undertakings represents an important milestone in our strategy to develop the raw material base, enhance our product portfolio and preserve our low cost position in the global steelmaking industry. At the same time, in the face of changing conditions for the global steel sector we have revised and further adjusted our expansion plans in order to significantly increase the flexibility of future capital expenditure.

We remain confident in the strong long-term fundamentals of our business model and believe that the actions being implemented across all of our operations focused on core production, efficiency improvement, the lowering of capital expenditure and streamlining of our business model, will provide safe passage through the current period of turbulence and economic uncertainty.

The agenda on our today's presentation is given on page two. Now please turn to slide four. We have been no less placing great efforts on our health, safety and environmental activities as safety remains our key priority. Despite the consistent effort being undertaken through the company, ten employees lost their lives as a result of work-related accidents in EVRAZ operations in the first half of 2013. All of these accidents have been thoroughly investigated and analysed in order to avoid reoccurrence and identify other workplace accident risks.

And now I'm handing over to our CFO, Giacomo Baizini for analysis of our first half 2013 results so, Giacomo, please.

Giacomo Baizini

Thank you, Alexander. Good afternoon, ladies and gentlemen. We will begin with an overview of our performance in first half of 2013 so please turn to slide five. As a result of the challenging conditions in the market for steel and steelmaking raw materials the company recorded a net loss of $122 million for the first half of 2013 compared to a net loss of $46 million for the first half of 2012. Falling prices in first half 2013 caused revenue to decline by 3.4% to $7 billion 362 million. Consequently gross profit fell by 7.1% to $1 billion 485 million and EBITDA decreased by 21% to $939 million. Free cashflow for the period was negative at $87 million – that is cash outflow. Net debt increased to $7 billion 43 million, mostly as the result of the consolidation of Raspadskaya's debt.

As of 30th June 2013 the company's cash and short-term deposits amounted to $1 billion 537 million compared to short-term debt of $1 billion 574 million. As of today we have no debt with maintenance covenants that require testing for the second half of 2014. Our steel sales volumes remain largely unchanged at 7.8 million tonnes compared to 7.7 million tonnes in the first half of 2012. So please now turn to slide six, some details of these results.

The decline in revenues was largely due to a decrease in prices in line with the general negative trends in the global steel industry. As a result of declining steel prices, particularly for flat roll products in Europe and the USA, and the temporary change to the company's product mix, EBITDA for first half 2013 was $939 million compared to $1 billion 184 million in the first half of 2012. The negative impact on EBITDA from decreased revenue was partly offset by lower costs of raw materials and higher volumes in mining. Now please turn to page seven to look at EVRAZ's consolidated costs.

Cost control means one of the key focuses of management so in the reporting period the cost of revenue decreased by 2% to $7 billion 362 million despite consolidation of Raspadskaya. The cost of raw materials, largest single cost item, decreased by 20%, driven mostly by lower coke and coals and scrap costs, which resulted from lower purchases of coal and scrap from market, higher intragroup coal supplied by Yuzhkuzbassugol, lower coal and scrap prices.

Staff costs increased by 16% due to consolidation of Raspadskaya and higher wages at certain operations. Higher transportation costs resulted from disposal of group's rail transportation subsidiary, EvrazTrans, consolidation of Raspadskaya and changed intra-group delivery terms of iron ore from FCA to CPT. Depreciation declined by 19%, mainly due to lower depletion expense at Yuzhkuzbassugol. In the reporting period the foreign exchange effect not had any material impact on costs compared to first half 2012. Please turn to page eight for the details on our free cashflow generation.

Cashflows from operating activities before changes in working capital fell by 42% in the first half of 2013 to $628 million reflecting lower product prices compared to first half of 2012. Working capital increased by $150 million in the first half of 2013 compared to the first half of 2012 due to increased sales activity in the summer months. Sorry, I think that is not quite correct. The cash, working capital increased by $150 million in the first half of 2013, meaning there was a cash outflow or investment in working capital of $150 million. Free cashflow for the period was an $87 million outflow as a result. Now turn to slide ten for our debt bridge and net leverage.

On this slide I would like to draw your attention that we have altered the methodology of calculation of debt in order to align it with the nominal size of our maturities. So there is a difference in the net debt that we – or the total debt and net debt that we report for 31st December 2012. This is not an accounting change in the sense that there is no IFRS definition of total debt or net debt. This is our definition that we reviewed to align it more with the nominal size of our maturities so we add back an amortised debt issue cost and the nominal effect of swaps on the rouble-denominated bonds.

So as you can see on this slide, our net debt at the end of June 2013 was just over $7 billion with the new methodology, having increased from $6.4, largely due to the consolidation of the debt that was acquire with the consolidation of Raspadskaya.

So if you now turn to page 11, you can see that we have cash and short-term deposits of $1.5 billion as of 30th June and short-term debt of almost $1.6 billion. A substantial portion of this debt represents trade finance instruments which are normally being rolled over so actually our first sizable fixed maturity of approximately – well, in fact, $660 million, $664 million, is in Q4 of 2014 which are rouble-denominated bonds that are due in October.

So turning now to page 13, we start a discussion of the business by regions so in general, EVRAZ's Russian steelmaking facilities continued to operate at utilisation rates which were close to full capacity. During the first half of 2013 revenues attributable to sales of semi-finished products decreased due to the client export sales prices despite an increase in sales volumes of Russian semi-finished products following EVRAZ ZSMK rail mill modernisation and ramp-up. Railway product revenues also fell as a result of lower sales volumes during the ramp-up of the modernised EVRAZ ZSMK rail mill. In spite of lower sales volumes prices for rail products remained resilient in the first half of 2013 compared to the first half of 2012.

The PCI project at EVRAZ NTMK reached full capacity in May 2013 and its implementation allows for coke and natural gas consumption rates per tonne of pig iron to be reduced from 405kg per tonne to 315kg per tonne and from 130m^3 to 75m^3, or by 22% and 42% respectively, based on the use of 133kg of

PCI coal per tonne of pig iron. The savings effect is approximately $10 per tonne of crude steel. So on page 14 there are several graphs illustrating that the consumption of long products in Russia is currently back at historic highs. So please turn now to page 15 for North America.

The US pricing environment remained challenging over the period with the spread between scrap and finished products shrinking, especially for tubular and flat-rolled products. The price effect weighed heavily on EBITDA of North American assets despite operational achievements in the reporting period. For example, the key focus of the flat product group in the period was enhancing capacity utilisation. To this end, EVRAZ North America is currently finalising works to increase the rolling speed at EVRAZ Claymont, which should improve productivity and provide capacity for higher output levels when the order book is strong.

Tubular product group concentrated on improving product rates at the seamless mill at Pueblo and on heat treating enhancement project at the Calgary mill. Revenue from tubular product sales slightly decreased in the first half 2013 as higher volumes, particularly of large diameter line pipes were unable to offset the fall in prices of tubular products. In the long product group we're progressing with the rail mill project at Pueblo which will allow us to improve rail quality, increase the mill's annual capacity and expand technical customer support and product development. The modernisation programme's proceeding as planned with product completion expected in mid-2014.

So please turn now to page 16 for iron ore mining. External sales volumes of iron ore products increased by 6.5% first half of 2013 compared to the first half of 2012 driven by higher volumes from EVRAZ Sukha Balka while inter-segment sales volumes decreased by 6%, primarily as a result of changes to delivery terms. The preparations for closure of the Irba mine at Evrazruda also contributed to lower iron ore volumes being supplied to the steel segment. In the first half of 2013 approximately 69% of EVRAZ's iron ore consumption was satisfied by own operations compared to 71% in the first half of 2012.

Cash costs of iron ore products averaged $63 per tonne in the first half of 2013 on a 58% iron content basis. In the iron ore mining division we continued to focus on cost savings and operational improvements during the period. At our key iron ore mining asset, EVRAZ KGOK we succeeded in maintaining cash costs of iron ore products at $53 per tonne for by-products, firmly securing the position of the asset as a low-cost operation.

So please now turn to page 17 for coal. External sales coal, volumes of coal products increased in the first half of 2013 by 350% due to an additional two million tonnes of coke and coal concentrate from Raspadskaya and higher sales of steam coal products following the repositioning of long-walls at Kusheyakovskaya and Gramoteinskaya steam coal mines in the first half of 2012. In the first half of 2013 approximately 68% of coke and coal consumption was satisfied by own operations compared to 48%, including coal from Raspadskaya, in the first half of 2012; also helped by introduction of PCI at NTMK.

Cash cost of washed coke and coal averaged $68 per tonne first half 2013. We continued the integration of Raspadskaya and delivered on previously announced organic growth options. For example, the development of the Yerunakovskaya VIII mine was launched in February, ahead of schedule and below budget.

Please now turn to page 18 for a recap, if you like, of performance by regions. So on this slide you can see that in the reporting period our assets in all key regions demonstrated positive EBITDA although the performance varied greatly. Clearly Russian operations remain the most resilient in terms of profitability due to the efficient vertical integration. In Ukraine we managed to demonstrate stronger performance in the mining segment both in terms of volumes and prices and the actions undertaken by the management of the steelmaking facility at DMZ resulted in better performance of blast furnaces. On top of this our coke batteries had a higher loading in the reporting period.

In South Africa we had better performance in the first half of 2013 compared to the first half of 2012 and in 2012 we had certain labour tensions that ultimately led to the strike in the third quarter, as well as due to the depreciation of the local currency compared to the same period last year. Europe was also marginally positive.

Now please turn to page 20 for detailed breakdown of capex. In the first half of 2013 we reduced our total capital expenditure to $492 million compared to $565 million in first half of 2012 on the back of delivering on several important investment projects. We finalised the modernisation of the rail mill at EVRAZ ZSMK, commissioned the Yerunakovskaya VIII coke and coal mine and saw our PCI project at EVRAZ NTMK become fully operational. We also made good progress with the Mezhegey phase 1 and Vostochny rolling mill projects, while the Yuzhny rolling mill project was put on hold in light of the current market environment.

In the face of challenging times for the global steelmaking industry management has revised and adjusted further expansion plans to reflect the weaker pricing environment. The updates to the status of our key investment projects can be found on slide 21. So now please turn to slide 93 – sorry, 23.

So summarising our performance in the first half of 2013 I can say that first half 2012 sales volume was broadly flat while first half 2013 financial results reflect weaker steel price environment. Lower prices were partially offset by a decrease in costs, especially in raw materials. We delivered on several major investment projects, rail mill modernisation, commissioning a new coke and coal mine at Yerunakovskaya VIII and PCI at EVRAZ NTMK. Capex was reduced compared to budget to reflect the weaker steel pricing environment in the course of the first half.

We have an ongoing optimisation of the asset portfolio with the sale of certain assets expected to close in the second half of 2013 and finally we have achieved a stable debt and solid liquidity position following the continued focus on debt management. So thank you very much for listening to our presentation. We are now ready to take your questions.