

PhosAgro

PhosAgro Q1 2017 IFRS results

Conference call and web-cast held on 17 May 2017, 4:30 PM MSK

Edited transcript

Speakers:

- Alexander Seleznev, Head of Investor Relations
- Andrey Sokolov, Sales Director
- Alexander Sharabaiko, Chief Financial Officer
- Andrey Guryev, Chief Executive Officer, Chairman of the Management Board, Member of the Board of Directors

Participants asking questions:

- Muneeba Kayani, Morgan Stanley
- Senan Kiran, Muzinich & Co
- Rahul Bhat, J.P. Morgan
- Marina Alekseenkova, Hypothesis Research
- Denis Gabrielik, Otkritie
- Mark Donikian, QBF Corporation

Operator: Ladies and gentlemen, welcome to PhosAgro Q1 2017 IFRS results announcement, conference call, and webcast. I will now hand over to Alexander Seleznev, Head of IR. Sir, please go ahead.

Alexander Seleznev: Ladies and gentlemen, good afternoon and welcome to our Q1 2017 earnings conference call. As usual, today we have the entire management team here in the room ready to answer your questions. First of all, the disclaimer: we will be making forward-looking statements during this conference call. The statements include, but are not limited to, statements about future financial and operating results. They are based on the management's beliefs and expectations as of today's date and are subjects to significant risks and uncertainties. Actual results may differ materially from projected results.

I suggest we will start with Q1 2017 key highlights. First of all, key highlights on EBITDA dynamics. In Q1 2017, EBITDA stood at RUB 12.7 bn, which implies a roughly 50% decrease y-o-y. The EBITDA margin stood slightly below 30%, which implies an approximately 15 pp decrease in EBITDA margin. Net income in the reporting period stood at slightly above RUB 12 bn, which implies a roughly 46% decrease in net income. Net margin stood at 28%, which implies a roughly 12 pp decrease in net margin.

Now, operating and free cash flow dynamics. Operating cash flow was down about 60%, primarily driven by the decrease in profitability and slightly weaker dynamics in the working capital. The CAPEX numbers were more or less flat y-o-y - that implies a slightly negative FCF for Q1. Despite all the headwinds in the Q1 2017, the Company is sticking to its dividend policy. According to the recommendation from the Board of Directors, the Company's EGM will vote on a dividend of RUB 7 per GDR or RUB 21 per ordinary share. That implies a roughly 50% dividend payout based on adjusted net income.

Now let us switch to the market context in Q1 2017. In terms of DAP prices in Q1, the prices recovered from the lowest that we observed in Q4 2016. The price increased in Q1 by 10% q-o-q, driven by a recovery in feedstock prices (primarily ammonia price), tight supply on the markets and growth in consumption. In terms of urea prices, they were well-bid in Q1 2017, and FOB Baltics was up by more than 20% in Q1 to more than USD 230 per tonne. In terms of key feedstocks, we would like to draw your attention to the ammonia price. In Q1 2017, ammonia price FOB Yuzhny averaged at USD 300 per tonne, which implies more than 50% increase q-o-q and more than 10% increase y-o-y. As to the demand, in Q1 the consumption was extremely strong, primarily in Latin America. In terms of the Brazil market, the overall demand in Brazil almost doubled in terms of P₂O₅ consumption, and - what is more important for us - in terms of MAP consumption it more than tripled.

The next slide is self-explanatory. Here we show the dynamics of DAP prices. A good recovery in DAP prices started at the end of 2016 – beginning of January 2017, and currently we are observing some softening in the prices after the end of the spring season in North America and Europe, and end of high season in China.

In terms of our sales for Q1 2017, we saw an almost 9% increase in the overall sales of fertilizers both nitrogen- and phosphate-based, as well as phosphate rock sales. Although in Q1 2017 our financial results were strongly affected by the rouble appreciation of more than 20% y-o-y and more than 7% q-o-q. The bottom left chart explains the EBITDA dynamics from Q1 2016 to Q1 2017. As you may see, the major impact came from the exchange rate fluctuation – impact of more than RUB 8 bn, and almost RUB 6 bn came from the decrease in prices. Certainly, PhosAgro, as a company with mostly USD-linked sales and RUB-based costs is suffering a lot from the appreciation of the rouble. Nevertheless, the Company remains focused on the things that we can control, particularly on cost control. In Q1 2017 cost of goods sold – we are talking about controllable costs only – adjusted for the increase in production, was up only 4% that is well below 4.6% CPI in Q1 2017.

Now, once again, the summary for Q1 2017. In Q1, we saw an almost 9% increase in fertilizers and phosphate rock sales. Phosphate prices recovered in Q1 q-o-q, driven by the feedstock dynamics and strong demand, especially in Latin America, although Q1 2017 financials were severely affected by the strong rouble. Despite all the headwinds (especially in FX), PhosAgro sticks to its dividend policy and tries to distribute close to the upper band of its dividend policy. The Company remains focused on its fundamental strengths: flexibility, netback maximisation, cost control and debottlenecking. Finally, at the end of April, we successfully placed our Eurobond at the coupon rate below 4%.

Now let us move on to financial performance in Q1 2017. In terms of revenue dynamics in Q1 2017, the revenue declined by slightly more than 20%, primarily driven by more than 20% appreciation of rouble. In the top right chart, you can see revenue by key products in Q1 2017. As you can see, more than 50% of revenue is generated by our key products: DAP, MAP and NPK(S). In the bottom charts, you can see the distribution by key regions in Q1 2016 and in Q1 2017. In Q1 2017, the share of Russia was almost 35%, Europe – 24% and North and South America – slightly below 25%.

The next slide is our usual one with y-o-y and q-o-q dynamics in the average revenue per tonne for our key products: phosphate rock, DAP, MAP, NPK(S) and nitrogen-based products.

Now on segment profitability. In Q1 2017, profitability in the phosphate-based segment was down by 40% y-o-y, and gross profit stood at RUB 17 bn. The gross margin in Q1 stood at 45%. In terms of nitrogen segment gross profit and margin, gross profit for the nitrogen-based segment stood at RUB 2.9 bn, slightly below 12% y-o-y. The gross margin for the nitrogen-based segment stood at slightly below 40%. In terms of phosphate

sales, they were up more than 9% in Q1 – the breakdown between export and domestic sales is shown in the top right chart. In terms of nitrogen sales, they were up by 7% in Q1 – please see breakdown in the bottom right chart.

Now CAPEX. In Q1 2017, CAPEX stood almost at RUB 9 bn, i.e. more or less flat on a y-o-y basis. Talking about the CAPEX/EBITDA ratio, it was slightly above 0.7x and our global target of 0.5x. Currently, we expect the finalisation of our key projects, so we believe CAPEX will go down. Talking about the key projects financed in Q1 2017, certainly we would like to highlight, first of all, the ammonia and urea units, Apatit expansion, modernisation of beneficiation plant No. 3 and a conveyor system at Koashva open pit.

Now on to the debt. In Q1 2017, the net debt/EBITDA ratio was slightly up from 1.4x at the end of 2016 to 1.75x. As I have said, at the end of April the Company successfully placed its new Eurobond– please see the details in the top right corner. Talking about the distribution of the Eurobond geographically, the main demand came from the US, Europe and Russia. Assuming that the new Eurobond was placed to refinance some short-term liabilities, you can find the updated maturity profile in the bottom left corner.

Now on the cost of goods sold. In Q1 2017, the cost of goods sold stood slightly above RUB 24 bn. That implies a marginal 2% increase y-o-y. The main impact on the cost of goods sold came from materials and services that grew about 12% y-o-y, primarily driven by a 10% increase in the rock production, 2% growth in fertilizers production and certainly CPI. In terms of D&A cost, D&A was up by more than 20% y-o-y, primarily due to the assets commissioning. In terms of ammonia expenses, they were slightly up by around 11%, primarily due to a 21% increase in the purchased volumes, which was almost fully mitigated by the decrease in the ammonia price denominated in roubles. And finally, sulphur expenses were down by almost 50% y-o-y in Q1 2017, primarily driven by a decrease in sulphur prices in the reporting period.

Thank you very much. We are ready to start our Q&A session.

Operator: Thank you. We will now start our Q&A session. Ladies and gentlemen, if you wish to ask a question, please press “01” on your telephone keypad. To participate in our written Q&A, please type your question into the “Ask a question” text area, then click the “Submit” button. Thank you for holding until we have our first question.

Our first question comes from Muneeba Kayani, Morgan Stanley. Please go ahead.

Muneeba Kayani: Hi, thanks for the call. I just want to understand what you are seeing from the Chinese producers. In a press release, you talked about some curtailments of production and exports from Chinese producers. How long do you think this will continue? What do you think is the Chinese cost of production right now and when do you think they would be back in the market? Thank you.

Andrey Sokolov: Ladies and gentlemen, we expect that the exports of phosphate-based fertilizers will go down this year. It is really hard to say by how much it will be cut, but we are quite positive and we expect the export volumes will be less. In our opinion, it should support MAP and DAP prices this year. Thank you.

Operator: Ms Muneeba, was your question answered?

Muneeba Kayani: Thank you, but what do you think the cost of production in China is right now?

Andrey Sokolov: We estimate the current cost of production for average Chinese supplies at around USD 330 FOB.

Muneeba Kayani: Thank you.

Operator: Ladies and gentlemen, I would like to remind you, if you have any further questions, please press “01” on your telephone keypad. To participate in our written Q&A, type your question into the “Ask a question” text area, then click the “Submit” button. Thank you for holding.

Alexander Seleznev: Operator, I suggest taking some questions from the webcast, if you do not mind.

Operator: Perfect. We have no further audio questions. Dear speakers, we can switch now to the written Q&A.

Alexander Seleznev: Currently, we have three questions from the webcast. Senan Kiran from Muzinich & Co. is asking: “Can you give some colour around Q2 2017 trading please?”

Andrey Sokolov: The beginning of Q2 was not very successful; we had some pressure on prices, first of all. This was due to the decrease in domestic deliveries for Chinese suppliers, meaning we started to export product and supply it for export, which is why we had some pressure. Currently, the situation is stabilising, and we expect that at the end of Q2 we could see more stable prices and even some increase in our netbacks. Thank you very much.

Alexander Seleznev: Another two questions are coming from Rahul Bhat from J.P. Morgan and Marina Alekseenkova, Hypothesis Research. Both questions are about our CAPEX guidance for 2017. The question is: “Can you please confirm your FY 2017 CAPEX guidance?”

Alexander Sharabaiko: We reiterate our guidance for RUB 30 bn to be spent over 12M 2017 as the guidance for the full year. We will give you updates in due course once we have a better understanding of what is being delayed or postponed, or if we cancel any of the projects that we have in the pipeline, but at the moment it is RUB 30 bn for the year. Thank you.

Alexander Seleznev: Operator, can we check if we have any questions on the phone line?

Operator: We have no questions on the phone line, dear speaker.

Alexander Seleznev: We have another question from the webcast. Rahul Bhat from J.P. Morgan is asking: “How would you think about dividends going forward now that the leverage is approaching two times, which is well above the target of one?”

Andrey Guryev: In terms of our policy, nothing has been or will be changed. I think we will continue to sustain the covenant that we gave to the market, so the dividend policy is 30–50%. Of course, Q1 compared to Q4 was quite tough for the whole industry. Nevertheless, I think we have been able to show quite substantial results. The Q1 numbers did not factor in the whole increase in prices, because some sales were made in Q4, in December. This also had an impact on our financial performance.

Nevertheless, we saw a very strong demand in the market - we continued to see quite strong prices at the end of Q1 and in Q2 right now in all areas; a lot of interest is coming from India. That makes us think that the worst two quarters are over. As for today’s market, we are running in a more stable market environment, and, as I said, what is particularly important to everyone is that there is a good forward-looking demand during this year. Of course, our net debt/EBITDA ratio, our covenants, profitability and EBITDA were hit by a very strong rouble appreciation, which I believe today should be normalised. As of today, we see verbal confidence from the government officials here in Russia - they are really keen and looking forward to a weaker

rouble in 2H 2017. I think it may – of course, it depends on many factors – also support our performance as an exporting company in the future.

Alexander Sharabaiko: Just a very quick add-on from my side. The key event that has happened during the quarter was not that we increased the amount of debt, but that EBITDA has significantly reduced due to the factors highlighted by Andrey. So, there is nothing wrong with our debt side. Thank you.

Alexander Seleznev: Operator, do we have any questions on the phone line?

Operator: We do not have any questions. Ladies and gentlemen, if you wish to ask a question, please press “01” on your telephone keypad. To participate in our written Q&A, please type your question into the “Ask a question” text area, then click the “Submit” button.

Alexander Seleznev: I suggest we continue with the webcast questions. We have the question from Denis Gabrielik from Otkritie. He is asking: “Do you reiterate your FY 2017 production target of 7.7 mt of fertilizers?”

Andrey Guryev: That is a good question. Again, it depends on how sustainably we continue our production. I hope that we will be able to make it to this target and maybe even 7.8 mt. We are working on it day by day, I can assure you.

Alexander Seleznev: We have another question from Mark Donikian. He is asking: “What are your expectations about FY contribution on EBITDA after the launch of new urea and ammonia units?”

Alexander Sharabaiko: As we mentioned during our Capital Markets Day, we expect the FY impact on EBITDA of additional USD 150 m given today’s pricing environment. If the prices are to improve, then this number will be towards the higher end. Thank you.

Alexander Seleznev: We have another question from Marina Alekseenkova. She is asking to recap on the schedule of the launch of new ammonia and urea capacities, and she is asking what the cash cost for the ammonia and urea production at the new units would be.

Andrey Guryev: I think it is a bit early to say today, but right now we can say that everything goes as planned for urea and ammonia; I do not think there will be any delay. Of course, in some cases, it is up to the people engaged in the construction and the will of God, but at the moment, we are totally on schedule, so we assume that we will make it to the scheduled date for the ammonia and urea production, which is August or early September. If this happens earlier, we would be very grateful. I can assure you that everybody is on the site today, it is almost 1,000 people and constructors working today on the ammonia and urea plant, finalising the construction. I believe we are on schedule and we will be able to show our performance in that respect soon.

Alexander Sharabaiko: As for the second part of the question on cash cost, the most important thing to understand is that the brand new ammonia plant is more efficient than the existing ones, that is a roughly 10–15% higher efficiency, which will be reflected in the cash cost. There would be 10–15% less than what we have today at the existing plants. Thank you.

Alexander Seleznev: We have no further webcast questions. Can we check the phone line, please?

Operator: We have no questions on the phone line. Ladies and gentlemen, if you wish to ask a question, please press “01” on your telephone keypad. Dear speakers, back to you for the conclusion.

Alexander Seleznev: Thank you everybody for joining us today and thank you for your interest in the Company. See you in August with 1H 2017 IFRS results. Thank you!

Andrey Guryev: Thank you!

Operator: This concludes today's conference call. Thank you for your participation, you may now disconnect.