

## PhosAgro

### PhosAgro Q1 2016 IFRS results

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#### Edited transcript

#### Speakers:

- Andrey Guryev, CEO
- Irina Evstigneeva, Head of Corporate Finance and Investor Relations
- Alexander Sharabaika, CFO and Member of the Management Board

#### Participants asking questions:

- Muneeba Kayani, Morgan Stanley
- Kevin Whyte, VTB Capital
- Nikanor Khalin, Alfa-Bank
- Konstantin Yuminov, Raiffeisen Bank

*Operator:* Ladies and gentlemen, welcome to PhosAgro Q1 2016 IFRS results conference call. Today's speakers will be Andrey Guryev, CEO, and Irina Evstigneeva, Head of Corporate Finance and Investor Relations. I will now hand over to your first host, Irina Evstigneeva. Please go ahead.

*Irina Evstigneeva:* Good afternoon, ladies and gentlemen, and good morning to those who have joined us from the United States. Today, we are happy to present our Q1 2016 financial results. As usual, we have the whole team of PhosAgro senior management in the room. I will do the presentation, we will try to make it as short as possible, and then Andrey Guryev, our CEO, and other managers will be ready to answer any of your questions.

First, a few words on the market context in Q1 2016. The DAP prices went down: the average price for the quarter was USD 370 per tonne (FOB Tampa), down 12% from the average price for Q4 2015 and down 23% from the average price for Q1 2015. We did not see the usual upside with the spring planting this year, but we do believe that the biggest pressure was coming from the commodity market. We all saw oil at almost USD 25 per bbl, and most commodities followed the oil, so DAP fell down as well. The low DAP price resulted in shutdowns of certain, rather large, capacities globally. For the first time, we saw big Chinese producers announcing the curtailment of production of over 1 million tonnes of DAP in Q1, which is high season in China. Certain other big producers were operating at lower capacities as well.

In terms of demand, in India, one of the biggest customers in the spot market, the subsidy levels were reduced, but only by 15% on DAP, while average prices came down by over 20%. At the time of the announcement, it was actually 25% to March last year. So, this subsidy level is very supportive, as regards either volumes or prices, or both.

Then, let us talk about another big customer on the market, Brazil, and the whole Latin America. The biggest problem of Brazilian farmers over the last year, very expensive credits, was resolved by the Brazilian government. In August last year, they declared that they would be subsidising the interest rate,

and the programme started working from the beginning of this year. So, farmers are getting debt at an interest rate below 8%. With that, although Q1 is low season for Latin America in terms of fertilizer purchases, we saw quite a significant upside in imports, already over 30% y-o-y, and we believe that we will see the same trend going forward.

In terms of urea, another big product for us, urea prices were under significant pressure as well. We saw increased competition in the urea market with the launch of certain US capacities. The average price for urea in Q1 2016 decreased below USD 200 per tonne to USD 194 per tonne (FOB Baltic). That was 21% lower than the Q4 2015 prices and 33% lower than in Q1 last year.

Speaking about pricing, as usual, we give you data on all prices for concentrated fertilizers for the past three years (almost). DAP is the green line on the top. DAP may have had less pressure than the two other concentrated fertilizers, urea and MOP, but the main factor is that the fundamentals are different.

[Prices are shown] versus the three emerging market currencies most important for the market and for us. As you can see, the rupee, the yellow one on the top, continues to behave pretty stable. This is another supportive factor for the good demand in India for this year. The Brazilian real has been somewhat strengthening since the beginning of this year, which is good for the Brazilian economy. And then, the Russian rouble reached the weakest level during Q1, but then strengthened by the end of the quarter. The weak rouble, as you know, helps us on the cost side versus USD prices for our products.

Talking about a more fundamental aspect, the cereal basket, it is the second year that we have shown the correlation between the cereal basket and the NPK fertilizer basket. Obviously, most crops need all the three nutrients. You can see that their affordability for farmers is at its absolute highest for the past five plus years. It provides great fundamental support to the demand for P205 and other nutrients this year. Also, if we look at the stock-to-use ratios, most of them are below their 20-year averages. Wheat is around its 20-year average, but it is more visible on corn and soybean. We have seen quite a significant recovery of those prices recently. Again, that provides and will provide great fundamental support going forward.

In terms of our results and financial performance, you can see most of our main indicators in the press release. Our revenues went up again, mostly on the back of the quite visible growth in volumes, 8% in sales and above 10% in production. EBITDA was RUB 25 billion, which is 3% higher than last year, although fertilizer prices are 23% lower. But the weak rouble, as we have said before, helps to offset the lower price environment, together with higher volumes and all our projects aimed at running more efficient production. EBITDA margin was 45% – an excellent margin. You would not see anybody else in the industry with such margins. Our [net] profit grew to an abnormally high margin, 40%. But part of this, to tell you the truth, is the USD vs RUB appreciation at the end of the quarter. You would see about RUB 7 billion of FX gain in the profit line, but even if you deduct it, the profit is great. That was the biggest reason for very good dividends. Net debt is actually below our target, below 1x, which also contributes to a very solid and stable balance sheet.

Comparing quarter on quarter, you can see that our performance against Q4 2015 was exceptionally good. Our revenues went up by 18%, while our cost of sales grew only by 15%. That shows the improved production efficiency. Gross profit increased by 21%; EBITDA by 28%; again, the EBITDA margin was 45% vs 41% in Q4 2015, although we had a much worse price environment. Net profit margin reached 40%, an absolute record; and we had a very good and solid free cash flow of above RUB 10 billion.

Now let us talk about the revenue breakdown. You can see in the top left corner that our three target markets as per the sales policy, our priority domestic market and two other target markets, where we opened direct offices, i.e. Europe, including CIS, and Latin America, [together] represented about 80% of

our entire sales. You can see that the biggest ones are exactly Russia, Europe and Latin America. In terms of nutrient segments, phosphate continues to bring us most of our sales and most of our margin, 88% vs 12% from nitrogen fertilizers.

Speaking of revenue per tonne in rouble terms, you can see that because of the weak rouble, most prices were stable against Q4 2015 or improved slightly.

The next slide shows the USD price environment. Again, you can analyse it yourselves, and if you have any questions, we are always here to answer any of them.

As for volumes, in mid-April you saw our operating results release. Here you have the breakdown by product type. Again, comparing exports to the domestic market, our domestic market demonstrated extreme growth in terms of volumes. That is all on the back of the import substitution programme, which is supported by the Russian government.

In terms of segments, as I have already told you, our favourite phosphate segment brings us most of our revenue and most of our margin. Gross profit margin in this segment is 58%, which is an excellent result.

The performance of the nitrogen segment, mostly driven by the fact that urea prices experienced deeper pressure – not only in Q1 2016, but over the last three years – was slightly worse but still generated 52% of gross profit margin. You would not see any other players in the nitrogen industry generating such excellent margins.

Regarding the cost of goods sold, I will again compare Q1 2016 to Q4 2015. The decrease in the cost of materials and services was mainly due to the fact that we sold the stock which we had accumulated by the end of the year in ports and on the rail. That was all sold in January. Our personnel costs went down; the biggest item here is annual bonuses, which were accrued at the end of 2015. We normally pay them twice a year. Then, speaking about different materials, our ammonium sulphate costs increased quite significantly, by 23%, but there is a very simple explanation for that: we had record production of various NPK fertilizers, many of them with a rather high nitrogen content. Sulphur costs increased by 26%. Again, most of that increase came from production volumes, as we produced much more NPSs. Then, there was a 9% price increase. Our pricing is now linked to USD prices, through a formula, so the exchange rate plays a significant role here as well. Potash costs increased by 13%. The same story here: record volumes of NPK/PKS production. And the last one, ammonia, showed an increase of 8%, and it is again due to larger volumes purchased because of the growth in fertilizer production. But we will get rid of these high ammonia costs very soon, because in 2017 our new, most efficient ammonia plant will start running, and we will be back to 100% self-sufficiency.

The slide on capital expenditure is self-explanatory. Major capex is now going into our new ammonia plant and the new urea plant. At the bottom, you can see the capex split by segment.

In terms of our balance sheet and debt, as I have already said, we are now below our target, which is 1x net debt to EBITDA in the normal course of business. Also, generating excellent free cash flow, we were able to reduce gross debt by about RUB 2 billion, which helped us decrease the ratio as well.

Speaking of the outlook, we are now entering the season when normally the biggest volumes are traded on the spot market, and that would mean sales to our two biggest customers on the spot market, Asia and Latin America. From June to September, about 70–75% of the whole spot market volumes are traded, and we do not expect any downward trend in the demand. As I have mentioned, all biggest consumers of P205 now have a very supportive environment in terms of higher fertilizer application. Looking at the affordability of prices, all fertilizer prices are now at the level of the 2009 global financial crisis. But on the demand side, we do not see any significant disruption, like back in 2009. If we think

about oil and other commodities, we have seen a rather good recovery in oil recently, almost twice up from the lowest levels back in February. In the past two to four weeks, we saw an excellent recovery in cereal and oilseed prices, mostly in corn and soybean. Actually, if you look at corn prices, they are now almost back to the level of the beginning of 2014, when they started dropping down. Then, soybean prices are 22% higher than in 2015, and soybean is the highest consumer of phosphate. The biggest grower of soybean, Brazil (and now Argentina is more likely to join it), no longer has problems with the expensive credit. We think that we will be seeing more acreage and more fertilizer use, as, with much better pricing, farmers will be interested in planting more and getting better yields.

Then, looking at the supply side, as we already saw in Q1, and the trend was the same in April, with these low prices there was a very significant drop in the Chinese export volumes, almost 40% for P205. If this trend continues, somebody else will have to replace big volumes which were traded from China last year to all destinations, but mainly to Asia and Latin America. So, we will see what happens, but this is a great supportive factor for prices going forward.

Then, looking at other producers, I guess you have seen that Mosaic was running pretty low capacity, but Mosaic, as us, is pretty bullish in terms of demand. So, we should be seeing higher volumes and, likely, better prices.

As to who will be able to replace China on the market if the Chinese exports continue to be low, the only real player would be, obviously, OCP Group, which started 1 million tonnes last year, and another 1 million tonnes is to be commissioned this year, although with a slight delay. We will see what happens, it is a pretty interesting environment.

In terms of PhosAgro itself, the rouble depreciation is helping us. Unless there is a very significant increase in oil prices, it is unlikely that we will see any substantial strengthening of the rouble. Therefore, it is more likely that through the end of the year we will continue enjoying much better margins in view of the weak rouble.

As for managing more fundamental factors, our offices in Sao Paolo, Zug and Warsaw are now fully up and running. Soon, two other offices are likely to be opened (in Germany and France). We are starting marketing efforts, so we will see better volumes. In addition, thanks to direct sales, we will enjoy better pricing in our target markets.

As we have seen in the past five to seven years, various grades of NPK and NPS, as well as NPKS (as you know, we are flexible) have been gaining better margins and showing some premiums vs concentrated fertilizers. There is a fundamental reason for that: the absence of the blending cost and, in certain grades, the absence of "empty" logistics in light of more nutrients in the same tonne. Our flexibility will allow us to meet any changes in the demand from farmers and, again, it should help our margins.

In terms of capital construction, all projects are on track to be launched in 2017, as we have promised. Again, it will benefit our margins, because we will be back to 100% ammonia self-sufficiency. That would be much more efficient ammonia production than most other ammonia plants globally. It would also help margins and help us expand our fertilizer portfolio.

With this, let me finish my presentation. Thank you, we are ready to answer your questions.

*Operator:* Ladies and gentlemen, we will now start our Q&A session. If you wish to ask a question, please press "01" on your telephone keypad. Thank you for holding until we have our first question. Our first question comes from Konstantin Yuminov, Raiffeisenbank. Please go ahead.

*Konstantin Yuminov:* Yes, hello. Thanks for taking my questions. Great results, really. A couple of things from my side. First, could you please address the Q2 performance, what is your view in light of the rouble strengthening and downward price trends?

In addition, I think there should be some maintenance works at two of your main sites – Balakovo and Cherepovets, meaning that production should be a bit lower. How do you go through this rather bleak quarter fundamental-wise?

I also have two rather technical questions. I have just noticed that the export price for AN was quite strong in Q1. It was around USD 230 per tonne, while the benchmark was around USD 180 per tonne (FOB Black Sea). Could you explain the reason for this gap?

And the same question on the domestic MAP price. It was higher than...

*Andrey Guryev:* This is too many questions for one question. We will start with the first question. Please repeat the first question, because I have already lost it.

*Konstantin Yuminov:* Apologies. The first question was about your view on the Q2 performance.

*Andrey Guryev:* In Q2, we will try to continue to grow in terms of production. We showed a significant volume increase in Q1, and this result should be sustainable during the whole year. By the year-end, I expect an increase in volumes of around 7–10%. We will definitely have an investment programme in place for that, but it will not be significant. Today, we are quite sure we will demonstrate better performance and efficiency at our phosphoric acid units, our nitrogen plants and so on. I think that we will continue to show good results, at least in terms of volumes.

The pricing is not as good as in Q1. The price for Q2 is a little bit lower. However, personally, I think that we have touched the bottom, and the bottom today is the cost of production of major Chinese producers, like, for instance, YTH, which already operates at 50% capacity, and it is one of the most cost-effective producers in China. India used to be the pricing floor for us, but today it is clear that, without the export duty in China, it is the Chinese cost of production.

In Q1, when there was a 40% reduction in sales from China, it already showed us quite positive signals that we definitely hit the bottom. Moreover, PhosAgro showed, to my mind, one of the greatest results in its history. Any significant, or even not significant increase in prices, which I expect will happen during this year, will improve our results.

There was an exchange rate volatility problem in Q2: the rouble was stronger. However, today the rouble may be getting back. With the current rate of around RUB 67, it will probably get close to RUB 70, so it will not have a significant impact on our results.

In short, the performance in Q2, taking into account the exchange rate and the prices, will be lower than in Q1. However, we will see a huge demand from the domestic market, which is the rouble market, and it should [mitigate the impact of the] FX rate difference.

*Konstantin Yuminov:* All right. In your report, I saw that the domestic MAP price was quite higher than the export benchmark. What was the reason and is it sustainable going through Q2?

*Irina Evstigneeva:* Konstantin, it is our distribution margin. It all depends on the grade, so, for example, you could see that NPKs were somewhat different. On the domestic market, we are distributors, so that is just netback, rail and distribution margin.

*Konstantin Yuminov:* OK, cool. My final question is on the AN export price: it was around USD 230 vs the benchmark of USD 180, which is a USD 50 premium. Was it also a technical matter, or were there any sales efforts behind it?

*Andrey Guryev:* I think this happened because a significant amount of AN went to the domestic market, which caused an increase in the AN price in the export market.

There is substantial demand from Russian farmers. As I have said before, it is currently bolstered by the Russian Government's support for agriculture and, again, by a relatively fine situation in agricultural markets in terms of revenues and commodity prices.

*Konstantin Yuminov:* Good. Thank you very much.

*Operator:* Our next question is from Muneeba Kayani from Morgan Stanley. Please go ahead.

*Muneeba Kayani:* What is the outlook on the margin benefit from the new ammonia plant once it is fully operational? That is my first question.

Secondly, your free cash flow will increase quite substantially once the capex at the ammonia plant is done. What are the uses of this cash and could the dividend payouts increase?

*Irina Evstigneeva:* Muneeba, I will quickly comment on the margin, and then Andrey will answer how the cash will be used.

You can calculate it yourself. Gas consumption of our current ammonia plant is around 1,080–1,090 million cubic metres. This one will be consuming 940 million cubic metres. You can calculate the difference from the cash cost of ammonia production, and it will be pure additional margin on 760,000 tonnes. There is also an annual effect (which, again, depends on our fertilizer portfolio) of around 200,000–250,000 tonnes, which we have been buying on the market at prices above USD 300 per tonne. It will all be gone and replaced with very low production cash cost of the new ammonia plant.

*Muneeba Kayani:* What cost of production do you expect given the current gas prices?

*Irina Evstigneeva:* At the moment, our current plant's cost of production is between USD 80–90 per tonne, but, again, part of that is rouble, so you should think of Morgan Stanley estimates for the next year's rouble, and then inflate it.

Still, if all remains the same (USD 80–90), then you deduct the efficiency in terms of gas consumption of around 15–20% on 760,000 tonnes, and, instead of USD 300, we will be running cash costs of approximately USD 65.

*Muneeba Kayani:* Thank you.

*Operator:* Ladies and gentlemen, if you wish to ask a question, please press "01" on your telephone keypad. Thank you for holding until we have our next question.

Ladies and gentlemen, if you wish to ask a question, please press "01" on your telephone keypad. Thank you for holding.

We have a follow-up question from Muneeba Kayani from Morgan Stanley. Please go ahead. Muneeba Kayani, your line is open.

*Muneeba Kayani:* Can you hear me?

*Operator:* Yes, we can.

*Muneeba Kayani:* My second question was on the free cash flow increase next year once the ammonia plant capex is done. What is the management thinking about the uses of cash and the dividend payout? Could it increase? Thanks.

*Andrey Guryev:* Thank you for your question. First of all, this free cash is not available yet: we need to finish the construction, as it is quite a significant development.

However, for the time being we do not have any other strategic ideas in terms of investment in our growth during the period of 2017–2020, except for the planned capex in our mines, which will be used for the expansion of our phosphate rock production.

So I think that your assumption that this free cash may be used for dividends may materialise.

*Muneeba Kayani:* Thank you.

*Operator:* Our next question is from Kevin Whyte from VTB Capital. Please go ahead.

*Kevin Whyte:* Yes, hello, thank you for taking my question. I would like to come back to the very short mid-term outlook on Q2 and Q3. As I understand, your overall view is rather bullish and looking forward to a turnaround in DAP prices at some point. However, so far in Q2, given the above-mentioned rouble exchange rates and fertilizer price trends so far into the quarter, it is not looking like your earnings will be the same in Q2. As a corollary, will you be provisionally maintaining your dividends at the same level, while waiting for your financials to improve as the market turns around? How are you reacting right now for the Q2 and Q3? That is my first question.

Second question: what is your production target for phosphate rock, since you mentioned that you are further expanding your production? Thank you.

*Andrey Guryev:* Thank you for your questions. First of all, I also believe that Q2 may be weak compared to Q1. It is partly due to the prices and the FX rate.

At the same time, I am expecting that we will see an increase in phosphate fertilizer prices, which will probably start in the middle of summer during the period of major fertilizer consumption. That is what usually happens. In addition, as I have said, the Chinese are more disciplined and are facing the problem of the cost of production, which may also increase.

Answering your second question about the production of phosphate rock, this year we are expecting production of 8.4 million tonnes of rock, which I think is a significant increase. This, again, will help us in terms of the free cash we will get from the sales.

What is also very important, if you compare our phosphate rock prices and, for instance, prices on other raw materials like sulphur, potash or ammonia, you will see that the phosphate rock prices are stable, or even growing in the US dollar terms. The rest of the raw materials are currently hitting the bottom and exhibiting a kind of a lower trend, which I think will be sustainable during the whole year.

*Kevin Whyte:* I understand you view phosphate rock as being more stable also in the short term and mid-term. Do you have a new production target for after 2017 and after that? Or is it stable?

*Andrey Guryev:* We will add up capacities in the phosphate segment, maybe, up to 9 million tonnes by 2020.

*Kevin Whyte:* And to recap on Q2 and Q3, you would just be sticking to your regular dividend policy, and so whatever you post in terms of net income, excluding the FX effect? Will you be staying within your dividend policy, regardless?

*Andrey Guryev:* First of all, I think that we already stick to the promises which we gave to our shareholders. If the situation allows us to continue that, and I believe there is nothing really going on in that direction which may harm or change it, I think we will keep suggesting to the Board that they continue to do so.

*Kevin Whyte:* Right, definitely. Understood. Thank you.

*Operator:* Our next question is from Nikanor Khalin from Alfa-Bank. Please, go ahead.

*Nikanor Khalin:* My name is Nikanor. Thank you for this call. I have just a few questions on capex. If you could provide us with a guidance for this and next year and, possibly, give us some colour on the exchange rate breakdown of capex and a breakdown into maintenance and development capex? Thank you.

*Alexander Sharabaika:* The target that we can provide for this year is RUB 43 billion. We calculate this target assuming a certain distribution between RUB expenses and USD expenses – about 30–31% is USD expenses, and about 69–70% is RUB expenses.

As for the next year, we are not providing any guidance as we are still in the mid Q2. I suggest you address the same question closer to the year-end and we will definitely be able to provide you with sufficient information. Thank you.

*Nikanor Khalin:* Thanks. Could you provide a breakdown into maintenance and development capex?

*Alexander Sharabaika:* Sorry, say again.

*Nikanor Khalin:* Could you break down this RUB 43–44 billion into maintenance and development capex?

*Alexander Sharabaika:* Well, it is pretty easy. About USD 90–100 million, depending on the exchange rate, would be the maintenance costs. The remaining part would be the development capex.

*Nikanor Khalin:* So, RUB 90 million is the maintenance cost.

*Alexander Sharabaika:* I am giving you [the figures] in US dollars, so you adjust it by the exchange rate, about RUB 6 billion.

*Nikanor Khalin:* OK, thank you.

*Operator:* Our next question is from Konstantin Yuminov from Raiffeisen Bank. Please, go ahead.

*Konstantin Yuminov:* My question is also to Alexander. Just to check on the debt side. The target is unchanged at 1x, right? And as for the gross amount, do you plan to cut it down a bit, as clearly the LTM EBITDA now is much higher than it should be by the year end, assuming a bit weaker Q2 and, probably, Q3?

*Alexander Sharabaika:* Hello, Konstantin. On the debt side, we reiterate the target for net debt / EBITDA at 1x; it remains unchanged. There are no changes here. One meeting ago the Board of Directors also approved the target to reduce our total debt by another USD 200 million. So, by the year end, the total debt should stand at around USD 1.5–1.55 billion. That is the target.

Yes, you are right, it becomes a bit more challenging than it was before, but we still see no obstacles that could prevent us from achieving this target by the year-end.

*Konstantin Yuminov:* Sure. And also quite [a] technical [question]: during the last call, you spoke about the updated strategy until 2020. Is it still in progress? Should we expect it very soon?

*Andrey Guryev:* I think, preliminarily, we will be able to present the strategy on the Investor Day which we are planning to have this year. Today, the strategy is being discussed quite heavily with the Board, and we are in progress with this and may be able to show it in November.

*Konstantin Yuminov:* OK, got it. Thank you.

*Operator:* Ladies and gentlemen, if you wish to ask a question, please press "01" on your telephone keypad. Thank you for holding. We have no further audio questions. We can now take the webcast questions.

*Irina Evstigneeva:* Well, in fact, I cannot see any webcast questions, so I guess we can wrap up.

*Andrey Guryev:* If there are no more questions, I would like to thank you again for participating in our quarterly conference call. Thanks for your questions. I hope you liked our results and our presentation. In conclusion, I want to say that we will continue to show the consistent growth that we have been showing in recent years. I think today the Company, PhosAgro, is increasingly in a better shape. In terms of cash cost and profit, today we are definitely a leader in our industry. We will try to keep it up and show the growth in the future.

Again, as yet another achievement – not in Q1 but in the past two weeks – the Company was included in the MSCI Index, which I think is a significant achievement for the Company, and for the benefit of the stakeholders. I think this is new. It gives other investors a lot of opportunities to come in and learn about our Company – for investors who have not been able to be part of our success. Thank you, ladies and gentlemen, for being with us today and goodbye.

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