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Operator: Good day and welcome to the NLMK Third Quarter 2017 IFRS Results Conference Call. Today's conference is being recorded, and at this time, I would like to turn the conference over to Mr. Sergey Takhiev. Please go ahead sir.

Sergey Takhiev:

Thank you Rachel. Good morning and good afternoon, Ladies and Gentlemen. This is Sergey Takhiev from Investor Relations at NLMK. Thank you for joining us today on conference call to discuss our third quarter operating and financial performance. As always, elements of our presentations are forward-looking and based on our best view of the market. We're going to have a brief presentation from company's chief executive officer, Oleg Bagrin, and acting CFO, Sergey Karataev, followed by Q&A. Senior vice president, Grigory Fedorishin, is joining us today and will be happy to answer your questions as well. That's all from my side, and I hand over the call to Oleg Bagrin.

Oleg Bagrin:

Good day Ladies and Gentlemen, and welcome to NLMK's Third Quarter Results Conference Call. I'd like to thank you for joining us today. I will start with an overview of our home markets and our performance. Then I will give you an update on our strategy execution and then present our outlook. Afterwards our acting CFO, Sergey Karataev, will walk you through our financials.

I'll start on page four of the presentation, which we circulated earlier, current trends in our markets. In the first nine months of 2017, demand in all our home markets increased. Consumption was very healthy across the board, from equipment and capital goods to construction and pipe manufacturing. In China, we saw recovering steel demand as well as capacity cuts and the seasonal supply reduction ahead of the winter season. This translated into high utilization rates in China and a significant reduction in Chinese exports, which dropped to the levels seen in 2012 and 2013.

Pricing environment is discussed on page five of the presentation. Broad-based demand recovery, low inventory levels and a reduction of Chinese exports supported steel price and growth across the main consumption regions. Price growth and limited cost pressure drove expansion of steel-making spreads. And this creates a very good base for the sector's performance into the fourth quarter, which is not something the industry usually delivers.

Page 6 shows our sales numbers. We have delivered another record set of results with a 3% sales growth on the back of stronger sales in our home markets. Our sales in the US are up 2% over the quarter and then the Russian domestic market sales are up 21%, thanks to favourable demand conditions. Europe lagged behind due to slow season and imports pressure. Nonetheless, this added up to an 8% increase in our home market sales to an all-time record of almost 2.9 million tonnes. This quarter we also posted further growth in high value-added product sales, which were up 2% over the quarter. We took full advantage of an improved demand from Russian pipe manufacturers as well as an improved economics for semis on the exports markets. We diverted sales towards more profitable products, increasing semi-finished product sales by 16%. And you can see this on the chart on the right-hand side at the bottom of the page.

Strong performance by our divisions continued. The strongest growth was posted by our Russian Flat division, followed by the ongoing sales growth in our US operations.

Now let's move on to an update on our strategy execution, which is presented on page 7. I'd like to share with you the progress we have made towards our strategic objectives. In the first nine months, we have already reached 100% of our targeted gains for the year. Total gains delivered by strategic projects were almost $270 million in the first nine months, and this is shown on the top right chart.

In the third quarter alone, gains from strategy execution exceeded $100 million. Operational efficiency programme continues gaining traction, with more than 470 projects launched this year. These projects had an overall impact of $84 million in the first nine months, mainly as a result of cost reduction and productivity growth. Gains from investments projects, which are back-loaded, were $185 million with productivity growth in iron ore pellets and fines production accounted for the lion's share. Projects to cut coke and gas consumption and also ferrous waste processing were launched in Q3. We expect a strong delivery: our strategic projects will support our results in Q4 and also into 2018.

Now let's turn to the outlook, which is summarized on page eight. Global steel prices are expected to seasonally soften, while reduced competition from cheap Chinese steel exports will certainly be price supportive. Russian enters into a low season, which will weigh on domestic steel prices. But on a positive note, this will be somewhat offset by strong export prices. In Europe, underlying demand remains solid, particularly in the regions and markets where we operate, such as machinery, automotive and energy. Destocking at customers and traders could be a drag for a price increase, prior to the year-end. The US markets should continue to benefit from economic recovery and reduced imports pressure. Local price premiums are now at multi-year lows, which will is an additional factor supporting prices. NLMK's capacity utilization will remain high in the Q4 and sales volumes will remain strong.

So this was my part of the presentation, now Sergey please go ahead.

Sergey Karataev:

Thank you Oleg, and good day everyone. I will go over our financial performance, give more details on cash flow generation and debt portfolio management. With debt, let's have a look on the third quarter numbers in a bit more detail, presented on page 10. Q3 revenues were flat, due to higher share of semis in sales while our volumes were up by 1%. Q3 EBITDA increased by 7% to $648 million on cost improvement, driven by Strategy 2017 projects. Margin expanded to 25%. Growth in profitability, working capital release and conservative CAPEX drove our free cash flow to $533 million, with a 64% growth quarter over quarter. Net debt to EBITDA ratio was 0.3X, down from 0.4X three months ago.

Let's move to page 11 and go through EBITDA growth and profitability of our segments in Q3 2017. Russian Flat Steel division reported strong results. EBITDA increased by a third to $453 million driven by strong sales volumes, steel price recovery and Strategy 2017 efficiency gains. Long Steel Division profitability rebounded from low levels of Q2 on better prices, while sales were lower due to high base of Q2 and local customer destocking ahead of construction season. Mining division posted 64% EBITDA margin; that is below the second quarter levels on lower selling price, which are expected to pick up in the fourth quarter. Our international operations showed high single-digit EBITDA margin. The results were partially impacted by the growth in stock prices. At the whole, the NLMK Group performance was strong, with the growth in margins and stable top line.

Please turn to the page 12 where we discuss cash flow dynamics. In Q3 our Company free cash flow increased by 64% to an all-time high of $533 million. Let me go for the major drivers behind this growth. Operating cash flow increased to $663 million, a growth of 47% on strong profitability. We had a $109 million release of working capital, as improved accounts receivables turnover in increased advanced payment on the back of sales growth in Russia. Also we decreased recoverable budget debt. These factors were partially offset by the growth of semis and rolled steel inventories at our US facility to support the growth in sales. Also inventories increased on the back of seasonal growth in winter scrap stocks at the Russian production sites. Q3 CAPEX was at $120 million, as a part of the payments being made for the installation of the pulverized coal injection system (PCI), and the financing of scheduled equipment overhauls at NLMK Lipetsk and Stoilensky.

Moving to debt position slide on the page 13. Gross debt was up by 6% to $2.6 billion, while our net debt decreased by 29% on the back of strong free cash flow generation. Our net debt was down by 29% to $0.7 billion. Net debt to EBITDA ratio decreased to 0.3X. Our short-term debt portfolio is at comfortable levels of $0.6 billion and well covered by our exceptionally strong liquidity position with $1.8 billion, and available credit lines of $1.9 billion. In the third quarter, we placed $500 million Eurobonds with a 7-year maturity and record low coupon of 4.0%. The proceeds were used mainly for the buyback of our 2018 and 2019 Eurobonds with coupon rate of 4.5% and 4.95%. As a result of this transaction, we increased average maturity of our debt portfolio from 3.4 years to 4.3 years; cost of debt was down from 4.2% to 3.9%. In October, we also repaid ruble bonds in the amount of $172 m. Improved liquidity and debt repayment schedule support dividend payments and company's development.

With this, I will pass the phone back to Oleg to summarize.

Oleg Bagrin:

Thank you Sergey. To summarize the presentation, Q3 was a successful quarter for the Group - we have posted record sales, improved our margins, delivered on our strategic objectives and generated all-time high free cash flow. Looking into the future, we remain committed to building up on this foundation. Our strategy, strong execution discipline and a solid balance sheet ensures strong shareholder returns going forward.
So this concludes our presentation and now we are ready to open the floor for questions. Thank you.

Operator: We'll take our first question from Nina Dergunova with Goldman Sachs. Please go ahead.

Nina Dergunova:

Good afternoon Gentlemen, thank you very much for the presentation. I have two questions on your near-term outlook. First on CAPEX, do you expect accelerating CAPEX in fourth quarter? Or it shall be broadly in line with previous quarters, like $120 million? And the second question relates to your outlook for the fourth quarter. You mentioned that you expect to see a marginal decline in sales volumes on the back of seasonality. Yet at the same time, you see further improvement in financial performance on widening spreads and strategy effect. So, does this mean that you see EBITDA margin practically increasing quarter on quarter? Thank you.

Sergey Karataev:

Okay, I will take the first one on CAPEX. So yes, in Q4 we expect some CAPEX increase to the level approximate to $220 - 230 million for Q4. That will give us roughly $550 million for the whole year. The major increase will be driven by maintenance CAPEX – we expect the level of $150 - 160 million – and development CAPEX at the level of $60 - 70 million.

Oleg Bagrin:

Okay and on your second question, as you would appreciate, we don't give guidance for margins for the bottom-line. But just to give you a kind of a broader picture, we do see some softening of the steel price into December. But having said that, the prices were quite strong in October and November, which were almost sold. And at the same time, the prices for raw materials reduced, starting from the kind of mid-Q3. So that led to the expansion of steel-making spreads into Q4 and that would obviously support financial performance and margins.

Nina Dergunova: Thank you. That's clear now.

Operator: Thank you, we'll move to our next question from Nikolay Sosnovskiy with Prosperity Capital Management. Please go ahead.

Nikolay Sosnovskiy:

Yes, hello, thank you so much for the presentation. I've got one short question on working capital. Basically, in the first half of 2017 you've had something like $300 million build up and in third quarter just reported $109 million release. So what should we expect in the fourth quarter? Will you be able to release these remaining $200 million? If not, what would be the year-end build-up you expect? Thank you.

Sergey Karataev:

Thank you, well, I should mention that actually, working capital increase in the first half of the year was driven by both sales increase and also price increase. So we had some price effect on our inventories. You remember that actually prices for steel products went up significantly. So it was one of the reasons for the working capital build-up in the first half. Talking about Q4, I should mention that, well, Q4 is a seasonally low quarter, and we will have some build-up in inventories for finished goods, and also you should expect some increase in account receivables because they will have some deliveries just in the end of the year. But on the other hand, I think we should expect some decrease in slab inventories in the United States. But I think the major impact on working capital in Q4 will be driven by prices because there will be some price increase in Q4, as it was mentioned before. But overall, working capital increase with Q4 will not exceed working capital release in Q3. So the potential impact in Q4 will not be higher than the release in Q3.

Nikolay Sosnovskiy: So it should be some build-up, but a very small one.

Sergey Karataev: Right, so it will be, yeah. It will not exceed anyway Q3 release.

Nikolay Sosnovskiy:

Actually, can I ask some small question on the other thing? On the dividend policy, basically one of your competitors is telling us that they're going to enhance their dividend policy by additional feature which would, let's say, say that if net debt to EBITDA is very low, the company can go above 100% of free cash flow in terms of dividend payments. Would you consider such a possibility for yourself if net debt to EBITDA is close to zero, below 0.5, you know, pay more and kind of retaining more optimal capital structure as a result of that?

Oleg Bagrin:

Well, first of all we do not have an objective to become net cash positive. So we think that current level of leverage, that is 0.3x, is already quite low and we're working towards sort of maintaining that at the more or less this level. So the liquidity management and the dividend policies will reflect the intention to stay at this level or above. Also, you know, we were in a kind of late stage of the investment cycle where all the major projects were more or less completed and financed. But we will start a new investment cycle so we will have to have some reserves to finance new projects. We'll talk more about that in Q1 next year when we'll be presenting the new phase of our strategy.

And then having said that, as we mentioned before, we think that it's not only the dividend policy that provides guidance for the investors, with respects to kind of the payout. It's also the dividend records. So we've just announced today the Board's decision to pay 100% of free cash flow for Q3. So that I guess reflects the intention of the management and the Board with respect to the payout at this level of capital structure.

Nikolay Sosnovskiy: Okay, thanks a lot.

Operator: Thank you. We'll move to our next questions from Boris Krasnosheev with Alpha Bank. Please go ahead.

Boris Krasnosheev:

Good day, Gentlemen, thank you very much for the presentation. Two questions on my side. First question is regarding the pelletizing factory. You brought it to full capacity over the last couple of quarters. Could you please estimate what's the current cash cost per tonne of pellets of the newly commissioned pelletizing factory? And if it's possible, what's the EBITDA of this pelletizing factory, let's say, in the third quarter on standalone basis? That's the first question. And the second one, you have a significant improvement on the cash cost per tonne of slab approximately 8 - 9% quarter on quarter. What's been the major drivers behind this improvement? Is it some decline of cost in coking coal prices? Is it some internal operating efficiency measures or something else? If you could just highlight what drives the improvement on the cash cost quarter-on-quarter in the third quarter.

Oleg Bagrin:

Okay, now thank you Boris, I'll take the first one. The new pelletizing plant which we launched end of last year beginning of this year is now running at an annualized capacity of 6.06 million tons of pellets, and this is not full capacity. We aim to achieve sort of, and exceed the passport capacity next year; we will aim to produce 6.4 million next year. As for the costs, the pelletizing costs, which was probably a reflection of the kind of the normal cost of this facility at this level of production, is $19 per ton of pellets, at the facility, and about $25 delivered to the steel-making site.

As for EBITDA, basically that is obviously a function of spreads between the pellets and steel . And we estimate it, conservatively, the EBITDA addition, the contribution for this project to be in the range of $150 - 170 million a year and you know, with iron ore in Q3 at $70+, this contribution is actually now higher. We estimate that this project already this year will deliver close or somewhat over $200 million contribution to EBITDA.

Sergey Karataev:

Yes, and on the cash cost of slabs decrease - you are certainly right, so the key driver for this cost decrease is coking coal price. More than 80% of this reduction relates to coking coal price.

Boris Krasnosheev: Okay, thank you very much.

Operator: And as a reminder, that is a star one if you would like to signal for questions at this time. Our next caller is Carsten Riek with UBS. Please go ahead.

Carsten Riek:

Thank you very much. Just one question left from me. In your long steel business, there's currently quite a bit of discussion about graphite electrode prices globally. Are you actually negatively impacted? And if so, what would be the cost impact in your view for next year? Thank you very much.

Grigory Fedorishin:

Hello, this is Grigory Fedorishin, so thank you for the question. So there is a negative impact, although it's much less pronounced in the integrated steel-making comparing to electric arc furnace routes. Company-wise, we are covered by annual contracts for this year. So in the first quarter numbers you'll not see the material impact, neither in Flat Products nor in Long Products division. For the next year, that depends on the price dynamics and it's highly volatile now. So for the last week, the price for electrodes went down on the spot market by $15,000. So it's difficult to predict where we end up. We don't foresee any material impact for flat products, because again the electrode consumption there is relatively small. For the long products, there will be probably some negative impact. If the prices stay more or less at the level where we have it now, it will be between $10-20 million for the division. But again, prices are changing quite quickly.

Carsten Riek:

Yeah, maybe a follow-up here. In your early negotiations with the suppliers, do you face any kind of sense of whether there's a physical shortage, do they actually cannot provide the volume? Or is it mainly just volumes is not an issue, it's currently just a matter of price?

Grigory Fedorishin:

Well, our view, our understanding is it's a matter of price. So there is enough capacity available to provide volumes required.

Carsten Riek: Okay, perfect. Very helpful. Thank you very much.

Operator: Thank you, our next question will come from Marse Enginues from Millennium Capital. Please go ahead.

Marse Enginues:

Hi Gentlemen, thank you for doing the call. I have several questions. The first one would be on the dividend policy. So obviously fantastic news that you decided to, or the Board is deciding to do 100% of free cash flow this quarter. Like you said, you're happy with your leverage and you don't want it to go down any further. The problem with free cash flow as a driver of dividends is that free cash flow can be very volatile because CAPEX is lumpy. Like you said, Q4 will be much higher, and net working capital quarter-on-quarter differs a lot as well. Is there any chance we could say that there is a minimum level of dividends, I don't know, $400 million, $300 million that you'll definitely pay, even if free cash flow is less strong? Until next quarter you said there will be $100 million extra CAPEX, there probably will be another $70 million extra working capital. Does that it mean that dividends will definitely be $200 million lower, or how shall we think about that?

Oleg Bagrin:

Okay, we have two metrics, which we consider, and this is basically, this is how it is provided in the dividend policy. We use the year's IFRS net profit and the free cash flow and we're trying to be somewhere – to find a balance between those two metrics, given the volatile matter of the free cash flow which you just described. And also the accounting distortions on the net profit which may happen, once in a while, with one-offs and everything else. So we're trying to find, you know, to operate within the range between those two metrics, which basically will balance out the problems, the issues with individual metrics being free cash flow and net profit. And we're certainly not considering introducing a kind of a minimum pay-out level, although in the future obviously you know the Board is following up on the capital structure and then the dividend policy. So, we're trying to be mindful of the feedback we're getting from the investors. And, obviously we're trying to have this discussion ongoing, in terms of being able to improve the dividend policy going forward. But for the moment we don't have any such plans.

Marse Enginues:

And can we count that it will be 100% of free cash flow or adjusted net income? Or could we go back to 75%, for example, because next year CAPEX will be higher?

Oleg Bagrin:

Well, it is clearly, you know, now at this point in cycle it is largely a function of the capital structure because this is one of the main drivers of basically managing the capital structure. But as we enter, as I mentioned, as we enter the new phase of the investment cycle, that may change. There will be other levers to manage the capital structure.

Marse Enginues:

So the 100% free cash flow payout this quarter is more of a, I guess, given the new phase of investments, more of a one-off than a sustainable policy?

Oleg Bagrin:

Well, actually it's not the first time we're doing that. We were close to 100% in Q2. Probably Q4, given that we expect a strong quarter, we may remain at this level. But again, that is subject to consideration by the Board.

Marse Enginues:

Okay. And can you comment at all about CAPEX plans next year, just sort of range of CAPEX you expect for next year versus this year?

Oleg Bagrin:

We're expecting a flat, sort of flat level of CAPEX. Well, actually it was going to be a little bit of a kind of catch-up. There'll be some carryovers from this year into the next year, so we expect a range of you know, $650 - 700 million.

Marse Enginues:

Okay. And if I may, I have another question. In terms of, you mentioned that obviously October-November steel margins are expanding versus Q3, which is why Q4 should be good again, right? What about on the mining side? It seems to me that domestic resources prices are up q-o-q still, even though they're expected to come down. So is the mining division going to have a very good quarter, year, q-o-q as well?

Oleg Bagrin:

Probably in Q4 it will be softer, because the prices are softer as the margins migrate into steel-making. But overall we as a Group will basically not have any impact of this price volatility, given that we're self-sufficient.

Marse Enginues: Okay, thank you very much

Operator: Thank you. Our next question will come from Nikanor Khalin with VTB Capital. Please go ahead.

Nikanor Khalin:

Good evening, thanks for presentation and congratulations on great results. I just have a quick question on your prices. Maybe you could provide an outlook on your selling price of flats and longs in Russia for fourth quarter and year-end. Thank you.

Sergey Karataev:

Okay, let me take this one. For the flat products, the prices are – on the domestic side, they're mostly driven by the exports, the global market trends. We expect the flat pricing for the rest of the year. On the long product side, given the low season, the prices for domestic rebar started to get down. We'll see the lower prices for the rest of the year. Also, most of it, or all of it is probably going to be compensated by reduced scrap prices because of the same seasonality. The spreads may actually remain quite on a healthy level.

Nickolay Korovin: That's clear, thank you.

Operator: Thank you, and as a final reminder that is star one to signal for a question at this time. Our next question will come from Sergey Kulgin with Argus. Please go ahead.

Sergey Kulgin:

Hello, could you please tell what was the reason for profit decline year-on-year? It fell by 8%; what caused it? Thank you.

Oleg Bagrin:

Just to make sure that we understood your question correctly, so what profit you referring to? Like net income or…?

Sergey Kulgin: Net profit, right. It was up 4% quarter-on-quarter and 8% down year-on-year.

Oleg Bagrin:

Well, net income is quite a volatile indicator, driven but not only by the operating performance, which as we already mentioned was quite strong. It's also influenced by the factors like foreign exchange gain or loss, and we had some loss because of the ruble strengthening and we have net position in US dollars so there was some loss there. There was also loss coming from our investment in NBH. That was the result of the last quarter with low seasonality. And there was some extra financing cost associated with the new issue of Euro bonds. So if you sum up all of those factors, they were one of the reasons, on top of operating performance, for lower net income.

Sergey Kulgin: Thank you.

Operator: Thank you. And we'll take a follow-up question from Marse Enginues, please go ahead.

Marse Enginues:

Hey, just quickly. You said because of the volatility of the free cash flow you will, when deciding the dividend policy, you'll be considering also the – did you say – adjusted net income? And how, if that's the case, how do you calculate that?

Grigory Fedorishin:

Well, the dividend policy is based on two metrics. And we follow net income as it is in IFRS financial statement. But if there are some, you know, one-off non-cash charges, or we didn't have those for quite some time but if there are some, if there are any, we may consider to adjust the net income for those purposes. But we believe this range between the free cash flow which is more driven by operations than the net income which is more like a financial indicator, really helps to keep the dividend pay-out in the right range.

Marse Enginues:

Okay, and would you consider next year, if CAPEX is a bit higher, to take – how high would you be comfortable taking the net debt to EBITDA position into the next year? Assuming some decline in steel margins as well. Would we have to go to 1X, 1.5X, or at what point do we start getting pressure on the dividend policy?

Oleg Bagrin:

We always said that, you know, 1.0 is a very comfortable level for us. And that basically used to be a requirement you know, for investment grade, for quite some time, was sort of a yard stick for us to stay investment grade. We can be comfortable with a higher level, sort of on a temporary basis, so 1.5 is also fine, as long as it can be managed.

Marse Enginues: Okay, thank you very much.

Operator: Thank you. And Gentlemen I see no further questions in our telephone queue.

Sergey Takhiev: Okay, so it seems that we have exhausted all the questions. With this we'd like to thank you, all the participants of this call, and just to remind you, if you have further questions, the investor relations team will be happy to assist you. And have a nice day. Thank you.

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