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TRANSCRIPT: Q1 2021 NLMK Earnings Call (IFRS)

Corporate participants

Grigory Fedorishin - CEO

Shamil Kurmashov - CFO

Dmitriy Kolomytsyn - Director for Corporate Finance, IR

Dmitriy Kolomytsyn

Yes. Good morning and good afternoon, ladies and gentlemen. This is Dmitriy Kolomytsyn from NLMK's Corporate Finance and Investor Relations team. Thank you for joining us today for our conference call to discuss our operating and financial performance in the first quarter of 2021. As always, the elements of our presentation are forward-looking and based on our best view of the market. The company's CEO, Grigory Fedorishin, will provide market overview and present key operating highlights. And after that, our CFO, Shamil Kurmashov, will discuss our financial results in more detail, and we'll then be happy to answer your questions. That's all on my side, and I hand this over to Grigory Fedorishin.

Grigory Fedorishin

Thank you, Dmitriy. Dear ladies and gentlemen, thank you for joining today's conference call. Before we start moving through the presentation, I'm pleased to note that today, NLMK's Board of Directors approved the recommendation of the first quarter dividends in the amount of $600 million. In March, we published our 2020 Annual Report that reflects the efforts we made last year to continue to excel in the ESG space. Most numerical GRI indicators disclosed in the reports, including greenhouse gas emission data have been verified by an independent auditor. In addition, the SASB industry recommendations and the TCFD standards are being applied for the first time in the report.

With this, please let me move to the main part of the call. I will start with key macro trends that were shaping the Q1 results and continue setting trends for Q2. Let's start with Page 4. Steel prices increased across the board driven by rising consumption and continued albeit less pronounced deficit of steel supply, largely absorbed in developed markets. Low steel product inventories in the supply chain served as an additional factor supporting price growth. The announced production cuts in China fuel sentiment further. Average flat steel prices in the US grew by more than 50% quarter-on-quarter. Prices for hot-rolled products at the end of March reached all-time highs, approaching $1,500 per metric tonne. Russian export prices as well as domestic prices in the EU advanced by 30-35% quarter-on-quarter. As a result, steel mills' profitability reached multi-year highs backed by more restrained dynamics for key raw materials. Let's now turn to Page 5 to discuss steel demand and raw material prices in more detail. The sentiment on our key markets remain positive, although subject to some seasonal factors. The current steel consumption in the US grew by 12% quarter-on-quarter owing to an increase in imports against the backdrop of a record price premium versus global benchmarks. The recovery of capacity utilization rates in the US was slower compared to other regions. Steel demand in the EU remained largely flat, held back by the slow pace of recovery in the automotive industry.

In China and Russia, steel demand was lower as a result of the high base of the previous quarter, owing to seasonal factors, including the slowdown in business activity during the Chinese New Year celebrations. Iron ore and coking coal prices increased on average by 27% and 15%, respectively. Coking coal quotations, however, ran out of steam in mid-February with the end of bad weather conditions in Australia.

Let's now please switch to Page 6 to discuss the company's sales results in the first quarter. Steel output increased by 12% quarter-on-quarter to 4.4 million tonne following completion of steelmaking modernization at NLMK’s Lipetsk site in Q4 last year as well as the completion of scheduled repairs at our Long products division.

Consolidated shipments decreased by 7% comparing to last quarter to 3.9 million tonne due to a number of reasons. First, we had lower spare pig iron for external sales because of one-off repairs at NLMK Lipetsk BF operations. Second, we resumed slab shipments to our US division on the back of scarce availability of third-party feedstock. The 240,000 tonnes of slabs that we shipped in Q1 would be converted and sold as finished products by the US division in Q2. Simultaneously, the slab sales to NBH (which are recorded as external sales) dropped by 18% quarter-on-quarter due to the investment upgrade of the hot strip mill at the La Louviere plant, which is part of our Strategy 2022 program. And finally, some of the materials get stuck at Black Sea ports due to adverse weather conditions at the end of the quarter. And again, those will increase our Q2 sales proportionally. Sales of rolled product at NLMK US rose by 16% quarter-on-quarter to 0.4 million tonne due to higher sales of hot-rolled and galvanized steel. This was driven by strong demand across all our main customers.

Now I would like to start to share my final remarks with regards to market dynamics as well as NLMK's expected performance in the second quarter. I'm referring to Page 7 now.

In the United States, planned repairs at local steel producers should contribute to constrained supply and keep prices elevated supported by strong demand. Continued restocking in the EU as well as ongoing recovery in key steel consuming segments have already extended the lead times into August-September suggesting solid pricing environment. HRC prices in Russia are likely to inch higher with the construction activity to be in full swing during spring-summer months. Solid performance of export benchmarks should provide additional support. High steel volumes, coupled with seasonally strong demand in Russia, the sale of stocks, we accumulated in Q1, as well as the upward trend in steel prices should positively impact the Company's second quarter financial results.

Now let me hand over to our CFO, Shamil Kurmashov. He will provide further details on our first quarter financial performance. Thank you.

Shamil Kurmashov

Thank you, Grigory. Good day, everyone. Let me now recap our first quarter 2021 financial results. Let's begin with Page 9.

Our revenue during the first quarter rose by 20% quarter-on-quarter to $2.9 billion. The key contributing factors were higher rolled steel prices and an increase in the share of finished products in the sales structure. Strong revenue and resilient price spreads during the quarter resulted in EBITDA of $1.2 billion. This is 31% more than in the fourth quarter of the previous year. EBITDA margin reached 41%.

Let us now move to Page 10 to discuss EBITDA and EBITDA margin dynamics by division. Almost all of our divisions demonstrated double-digit growth in profitability as compared to the previous quarter. EBITDA at the Russian Flat products division grew by 66% to $772 million, due mainly to wider steel product/raw material price spreads fully offsetting a 6% decline in sales volumes.

The Russian Long Products division's EBITDA posted a three-fold growth quarter-on-quarter, amounting to $90 million with the expansion of the scrap/long product spread as well as with an increase in sales volumes.

In the Mining segment, EBITDA increased by 27% quarter-on-quarter to $432 million owing to rising prices and investment project gains.

EBITDA at NLMK USA stood at $65 million in the first quarter compared to minus $22 million during the same period of last year. But on a quarter-to-quarter basis, EBITDA declined by almost 40% due to the high base of the previous quarter, when the refund from the US Department of Commerce in the amount of $97 million was accrued in line with the settlement agreement. Without the accrued refund, the Segment's EBITDA would have increased six-fold quarter-on-quarter, supported by expanding spreads and sales volume growth.

EBITDA at DanSteel remained flat at minus $4 million due to the simultaneous increase in slab and plate prices. Finally, NBH's EBITDA turned positive and grew to $8 million compared to minus $28 million in the previous quarter and minus $19 million a year earlier due to the expansion of spreads at our flat steel facilities.

Let us move to Page 11. Free cash flow increased to $452 million due to an increase in EBITDA and a seasonal reduction in capex. Working capital build-up totaled $289 million, driven by the key two factors. First of all, receivables increased due to higher prices for steel products, higher sales in the Russian market, and the low base effect of the 2020 year-end, when we experienced accelerated settlements with the customers who anticipated further price growth. These factors consumed more than $300 million. And the second largest factor, growing prices resulted in higher cost of raw materials and finished products in stock. This was partially compensated by reduction in scrap inventories in line with seasonal patterns. In total, this resulted in $115 million of outflow. On the other hand, a $127 million inflow was caused by an increase in payables amid rising coal prices.

Let's move to Page 12. Let's take a look. There is some of key metrics showing our balance sheet strength, we ended the quarter with almost $840 million of cash at hand and the $1.9 billion of undrawn credit lines, which remain at our disposal, including the revolving credit facility of EUR 600 million and ESG-rating-linked facility of EUR 250 million that will be used to refinance existing working capital lines.

We retired $560 million of maturing debt, leaving us with the total debt of $2.9 billion which represents a 16% decrease quarter-on-quarter. As a result, net debt decreased by 16% to $2.1 billion, Net debt/EBITDA ratio going down to 0.65x. As always, the liquidity on the balance sheet fully matches our short-term needs. About 60% of the outstanding lines will be refinanced. And the rest is to be settled, including $300 million in the second quarter of 2021. I would like to end with the average cost of debt being at 3.1% reflecting the maturity of several cheap working capital lines.

This is it for my part. Thank you and we are now ready to take your questions.

Questions and answers session

Dan Shaw - Morgan Stanley

Just had a couple of questions. First one, sort of more on the market situation, if China does reduce exports going forward what is your view on how you think the Russian steel market can respond? Can it produce more flat steel? I'm not talking just about NLMK, but the market in general. Do you think there's any excess flat capacity that can bring a bit more flat steel to the market in Russia? First question.

Grigory Fedorishin

Thank you, Dan. I'll take this one. Generally, the flat producers in Russia are fully utilized. So we may think of rebalancing between the domestic market and the export markets. But in terms of the reserves, I can count only on MMK recent modernization of the rolling mill. It should add about 1-1.2 million tonne to the market in annual terms. Otherwise, there is no excess capacity available.

Dan Shaw

Okay. Very clear. And then the second one, just on working capital, obviously, you had a buildup of working capital in the first quarter. I assume we'll probably see the same in the second quarter. Do you have a view on sort of roughly how much that might be?

Grigory Fedorishin

It's really difficult to comment on this one, given the volatility of the market because the main factor behind the growth of the cash outflow to the working capital is prices. So it really depends on the level of prices we will see in June-July. Otherwise, taking into account manageable factors, part of the stocks or all of the stocks that we accumulated at the end of the first quarter in terms of the slabs in the ports and the slabs that we supply to the US, because we just have restored this supply chain, should be transformed into the revenue line in the second quarter. But on top of this, you know that we have a long supply chain to Europe and the US and the given margins, the healthy margins there, we will keep increasing volumes on these directions. So that may contribute to working capital build-up. But again, it is subject to the market at the end of the quarter.

Dan Shaw

Okay. And just one follow-up. Can you just remind us what is the sort of approximate lag between spot prices and when those actually get recognized in the P&L? So which month would sort of April prices be going through your financials?

Grigory Fedorishin

It's about 2 months, I would say. So the April prices should be [..] end of May-middle of June.

Maria Martynova - Gazprombank

Congratulations with good results. I have 2 questions. First, could you kindly provide a guidance on capex dynamic in the second quarter? And my second question concerns your American assets. North American steel market is currently in a very good shape. Could you provide your estimates for shipment dynamic for the second quarter and the whole year? Additionally, it would be very useful if you precise cash cost in this segment which can we observe from now.

Grigory Fedorishin

Maria, asking about the cash cost, do you mean the flat cash cost or US cash cost?

Maria Martynova

The US cash cost.

Grigory Fedorishin

Well, for the capex, for your first question, I would reiterate the guidance for the year which is $1.1-1.2 billion for the full Group for the year. And they may be fluctuations between quarters. So usually, we do not provide quarterly guidance. Also, I would expect higher capex comparing to the first quarter, given its better seasonality for the construction and we're quite active in our investment program. On the US market, we are ramping up our deliveries of slabs to the US. So the sales of the US rolling facilities will grow comparing to the first quarter. All in all for the year we plan to supply, Dmitriy, will you help me?

Dmitriy Kolomytsyn

1.2 million, yes.

Grigory Fedorishin

1.2 million tonne of slabs to the US. And the cash cost there, I suggest we take this off-line. I do not have numbers with me on that.

Nina Dergunova - Goldman Sachs Group

Congrats with good results and hefty dividends. We're expecting even better results in the second quarter, so a great start of the year. I have 2 questions. Both are related to this exceptionally strong market that we observe currently. So the first is the following. Could you please discuss if and how these persistently high prices changed your sales strategy? Shortening order books, any other differences in your approach to sales that you have seen such high prices in the market?

Grigory Fedorishin

Nina, if you are talking about the first quarter, the main development was that we restarted our slab supplies to the US, which was prohibited, given the duties, in the previous periods. Second, we observed a domestic market discount during the first quarter. So we had to balance between the export and domestic markets. Also, I would not say it was critical because we observed strong demand both in flat and the long segments. And the long segment is traditionally domestic. That helped us to preserve more or less the same balance. Besides, in the second quarter, on one side, we had good seasonality in Russia, especially in construction, which means Longs should perform well and remain highly utilized. On the other side, as I said, we are going to grow supplies to the US and Europe on the back of the strong margins there. I would not expect any big deteriorations in our traditional balancing of the portfolio. We will see the opportunities when they become available, but I would not say it is dramatically different from what we usually do at this time of the year.

Nina Dergunova

That is clear. And the second question is also related to exceptionally strong market. Can this change somehow your capital allocation priorities and centralize your investments or any other changes in the way you allocate capital?

Grigory Fedorishin

As you know, we remain quite disciplined in what we do, both in terms of our strategy and capital allocation. We will definitely respect our dividend policy this year and going forward. And again, the guidance for the year remains the same. We are well on the track to realize our Strategy 2022. We have just started to think about the next phase of the strategic cycle, and we will provide the market with first ideas probably at the end of this year. But that will not impact this or next year. That will impact several years going forward. So I wouldn't expect the capex materially different from what we are guiding for.

Nina Dergunova

That is clear. So just a very short follow-up. Can we expect a stable capex next year of around $1-1.1 billion?

Grigory Fedorishin

Yes, that is the right range. So we think in our forecast, we will have the same range for the next year.

Ivan Salkovskiy - VTB Capital

Just a couple of questions from our side. First question, we now see some discussions in media about the Russian Steel Association proposal to give some discounts to state contracts. I just would like to know if you have any vision when the final decision on this question is to be expected?

Grigory Fedorishin

Thank you for the question. We are in discussion with different levels of authorities on this one. As for me, the problem is not really in the price itself, but it's in its volatility. So when someone enters a long-term construction contract and does not hedge for the price during the construction period, someone may face the periods like this one when prices are peaking. So what we are discussing now is … we would encourage our customers in the construction segment, including the segment that relates to the state construction, to enter longer-term, more stable formula-based contracts like we do have for industries like automotive and machinery, where their price dynamics is much less volatile. What you see now in the media is the reflection of this discussion. How we can avoid current high split spot pricing in favor of longer-term, more stable prices, which is actually valuable for both sides. So these discussions are ongoing.

Ivan Salkovskiy

Very clear. And the second question, could you please share with us your current prices, your April HRC Black Sea prices that you use in your contracts that you have signed now, I mean, contracts for May and June?

Dmitriy Kolomytsyn

For May and June, I would just use current HRC FOB prices because we do not really sign contracts with anyone. We just use spot prices. Feel free to use them.

Ivan Salkovskiy

Ok. And just for the last small question. Could you please share with us your plan for your consolidated sales volumes for 2021 maybe change versus the 2020 level? I mean, in 2020, it was, like, 17.5 million tonnes.

Grigory Fedorishin
This number includes very different components like pig iron sales, which are sort of opportunistic sales for us, or billets, or in previous years, we also used to have sales of the iron ore concentrate or pellets to the market because of temporary misbalances in our operating chain. I would not comment on this number because that is the subject to very different markets and opportunistic sales.

What I can say in terms of the manageable factors is: because of the modernization that we have just completed this year, Lipetsk site should produce 1 million tonne of steel more than the normal life level (which is 2 million tonnes more comparing to the last 2 years when we had a big capital maintenance projects on that site). This is certain. You may expect plus 2 million tonnes of steel production year-on-year at the Lipetsk site. The rest is subject to the market.

Andrew Jones - UBS Investment Bank

Just a few questions on the market. First of all, with the strength we have seen of late, I was wondering how you see the European market? Because it seems to me that a large chunk of the price is due to destocking. When do we see this actually coming to an end? I mean are you anticipating this being something that will last for 2-6 months. So I mean, could you give us some idea from your European customers, what you're seeing there?

And then just on the change in your sales mix. I mean you are obviously lifting, as you said, slab exports maybe by like 2 million tonnes, 1.2, you said, is going to the US potentially this year. Where are those extra volumes going apart from the US? And just as a follow-up to that, we have just seen March data shows that Chinese exports started to pick up back into kind of previous high levels, at least on a monthly basis. Whether or not that is sustainable in Tangshan, who knows. But I mean, if the Chinese do seem to be exporting more, you sold quite a lot to Southeast Asia last year. I mean are you seeing that competition coming into the markets that you've been selling to recently? And how do you see that potentially changing the mix of your export sales?

Dmitriy Kolomytsyn

Yes, Andy, I'll take the first and the third questions. Regarding the European Union, I think it all comes down to the supply/demand balance. We start seeing the utilization rate in Europe going back to the pre-COVID levels. It's about 85-86% right now. A year ago, it was about 60%. So it is a big improvement year-on-year. And I think that should steadily lead to supply meeting demand that will probably take about 3 months because summer months and spring months are usually quite intensive in terms of seasonality. One of the problems that we have also observed in Europe coming from some of our customers is that they see shortage of containers, so they cannot physically move sometimes steel products or final steel products. So that is another issue that some of the European customers are dealing with. And in the US, by the way, the utilization rate is much lower, it is about 77%, so there is still space to grow. In terms of China, yes, we did observe growth in Chinese exports. During the first 3 months, they were up and they were up significantly in March. But I would attribute this to seasonal factors in the Chinese New Year. And I would expect in April and May exports to decline and that should lead to alleviate some pressure. Also, you know that in Tangshan, they started reducing production. There was a reduction in blast furnaces production, but also a pickup in electric arc furnace production. So that means that demand is still there, and that should not lead to significant reduction overall in Chinese production. But again, we would rely on demand picking up in April-May and further into summer months with construction slowly picking up. Take a look at the excavator sales, they continue growing. And I think it is a good indication in terms of where the construction activities are happening in China.

Andrew Ian Jones

Yes, I just going to ask on the extra slab volumes. Are you able to, say, ship more into Europe this year as a result of the sort of tightness in the market there? Now it is about 2 million tonnes. I mean how much of that is going into Europe?

Grigory Fedorishin

First of all, I will use the chance to adjust myself - the number I was giving on the US of 1.2 million. It is actually going to be a bit lower. I would say 0.9 - 1 million tonne of steel this year, as we have to account for the growth for the very low base in the first quarter. And we also keep consuming some third-party feedstock in the US where we can find it.

On top of the US, our traditional slab markets are strong. So we do supply slabs in Turkey. In Turkey, both, domestic consumption, as you know, and the exports to Europe are growing. That creates a good base for slab consumption. We do also supply some slabs to the US. The fourth destination is Asia, but that is subordinate to others that I have mentioned because of higher transportation costs and lower profitability as a result. So overall, we see very strong slab portfolio for Q2 and part of Q3.

Dmitry Smolin - SKB Bank

Just 2 questions from my side. First, on prices. We are currently are observing very high HRC FOB Black Sea price. The discount to domestic prices is also material. From what I can see it is more than $100 per tonne of HRC. So do you expect this discount to become a premium again? Or during the second quarter or in the second half, what is the average discount do you expect for 2021?

And the second question is - we see very strong performance from your, for example, US assets this quarter or Long Steel product segments. And for example, in your Long Steel segment EBITDA margin was 70%, which is a somewhat record high and given the current strong price environment, can you see the potential sales of some foreign assets or Russian long product assets? Alternatively, given the strong EBITDA margin in the mining segment, do you consider any potential buy out of mining assets?

Grigory Fedorishin

As for the domestic premium, it is really a volatile pricing environment now. Structurally, in the long term, we believe that the premium should be in the range of $30-50 in the domestic market, given the netbacks and other factors. Now you are right, it is quite a significant discount, both because of the domestic market lagging behind export benchmarks, but it is also because of the weak ruble, which is a big factor to the discount. Whether it is going to normalize soon, well, usually it takes at least several months to normalize, and it is subject to, well, seasonally strong second and third quarters in the domestic market, how the FX rate performs and the export benchmark. So I will not give you any direct guidance on that. In the long term, they should normalize. But when it happens next or third quarter, I am not sure.

On the US and then the Long products, you are right. These assets are generating good margins now. Long products is an important part of our portfolio of domestic sales. For the US, you know that our slab supply model does not work the way it used to work because of the slab duties but we are expecting the signals and changes from the new US administration, their trade policies and how these 25% import duties will evolve both for slabs and other products from Russia or otherwise.

We sort of pause and wait and see before we formulate the strategy for this division. Again, long story short, both assets remain the part of our portfolio and the business model. And the investment programs there and other programs that we have on these sites continue as usual.

On M&As, we have articulated our strategy, and it is mainly shaped by organic growth. And we are implementing all these projects. We have a pipeline of opportunistic M&A opportunities, but we do not really count on them in terms of difference in the strategy. I hope it answered the question.

Ivan Salkovskiy - VTB Capital

Just one follow-up. You have been talking about Lipetsk site and additional production. You have been talking about 1 million tonne or 2 million tonnes per year? I suppose 1 million, but I am not sure.

Grigory Fedorishin

You are right. Structurally, it is 1 million. In comparison to the level of, for example, 2018 as a, sort of, normalized level of 13.2 million tonnes for the site. Because of the reconstructions and modernizations in the upstream and blast furnace and BOF capacities, structurally we grew the production by 1 million tonne to 14.2 million. But last 2 years we lost some volumes of steel because of those capital maintenance and modernizations, the production at Lipetsk was actually lower. So it was 12 million plus. Compared to the last year, it is 2 million; compared to the structural level, it is plus 1 million. Hope it is clear.

Timothy William Riminton - Barclays Bank

Just on the topic of transport. I am just wondering what share of your steel exports go via Black Sea versus other routes for export or domestically?

Grigory Fedorishin

We do not sell billets domestically. I mean did you ask about billets?

Timothy William Riminton

Black Sea export route.

Grigory Fedorishin

Okay. Domestically, we do not sell billets. If we do, the billets produced, they are immediately transformed and sold as a rebar on the Russian market.

Timothy William Riminton

I was asking about the export route via the Black Sea.

Dmitriy Kolomytsyn

Do you mean how much we sell using Black Sea ports overall?

Timothy William Riminton

Yes, exactly.

Dmitriy Kolomytsyn

We will come back to you on this. We do not have this number off the top of our heads.

Timothy William Riminton

Okay. Sorry were you going to say something?

Dmitriy Kolomytsyn

When we sell to Europe and to Turkey, we use the Black Sea port. And when we sell to the US, we use northern ports. But we will come back to you with the breakdown. We do not have this number handy.

Timothy William Riminton

That would be very helpful. And then my second question is just more generally. We have seen some Russian issuers come to the Eurobond market lately. And I was just wondering sort of from your position, currently, how do you see Eurobond prices for you? And how do they compare to your domestic bank financing options?

Shamil Kurmashov

Currently, we have cash liquidity at hand but if there is a good market and we have certain expectation of the growth in the interest rates in the near future, we might revisit this opportunity and go for Eurobond market. So we are now monitoring the market and try to assess whether it is relevant for us to enter the market at the current moment or not.

Grigory Fedorishin

Just to add to this, as Mr. Riminton was asking about domestic banks. We do not really borrow, at least materially borrow, from domestic banks. So it is either public markets or, maybe, club deals or similar deals internationally. When we compare Eurobonds with those deals, some of them we have had recently and we announced those deals. The pricing is really comparable. You can find the deals on the private market, if I can put it this way, which are at least comparable to the Eurobonds. So there are alternatives.

Shamil Kurmashov

Related to the Russian banks, we have standby credit lines with the Russian banks. And they could be drawn down at any moment we want. But now we do not recur to them because of the not-so-favorable pricing as we can achieve in the international markets, taking funds in different currencies.

Dmitriy Kolomytsyn

We would like to thank everyone who joined this call. Thank you very much for your questions and attention, and we are looking forward to seeing you again in about 3 months.