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NWR.L - Q3 2014 New World Resources Plc Earnings Call

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PRESENTATION

Operator

Good day and welcome to the New World Resources third quarter results conference call. At this time, I would like to turn the conference over to Mr. Radek Nemecek. Please go ahead, sir.

Radek Nemecek - *New World Resources Plc - IR*

Thank you. Good morning, everyone. Thank you for joining us on this conference call to discuss our nine-month results.

We are joined today by Marek Jelinek, the Executive Director and CFO of NWR, who will walk you through the presentation slides, which I hope all of you are able to access at this time.

Please note that this call is being recorded, and as always, at the end of the presentation, we will open the call for the questions.

With that, let me hand over to Marek.

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

Thank you Radek. Good morning everybody. Thank you very much for taking the time this morning.

I will start with an executive summary of the key highlights of the reporting period, January through September 2014, and then I'll move on to a more detailed discussion of the financial performance.

I will then touch upon the results of the recently concluded balance sheet restructuring and we'll talk about our expectations for the remainder of the calendar year 2014, as well as a first glance at a guidance for the calendar year 2015.

So starting on -- for those of you who have the slides, starting on slide 5, you will see a top line revenue reduction of 21%, which is mainly driven by the unfavorable pricing environment as well as a reduction in the actual output. This is, to some extent, offset by an increase in the coking coal proportion in the overall mix.

Clear, good achievement on the cost side, where cash mining unit costs were down 16% and the selling and administrative expenses were down even further, 26%, which to some extent, has offset the weak top line development and led to a positive EBITDA of EUR4 million for the period, which is a significant improvement on the EUR50 million negative EBITDA in the same period last year.

In terms of net debt, again those of you that are looking at the slides, you can actually see two net debt figures that is because the balance sheet restructuring has closed on October 7, i.e., after the balance sheet date of the period under review.

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For those of you who have read the OFR, you will have seen a very detailed pro forma balance sheet that shows the September 30 balances adjusted for the outcomes of the restructuring. And I will talk more about the restructuring in a few moments.

Moving on to slide 6; I'm happy to report another improvement in our safety performance with the lost time injury frequency rate at 7.19. Our coal production was at 6.3 million tonnes with coal sales at 6.1 million tonnes.

The coal mix at the end of -- or at the January through September period, was at 60% coking coal and 40% thermal.

CapEx was down 56% on the previous year and the total headcount was down 8%.

Looking at the steel production in our relevant region, in what we call Central Europe; at the bottom right-hand side of the slide you can see that we continue to operate in a rather tough environment with only a moderate 3% increase in steel output year on year. And the global steel capacity utilization is still stagnant at around 75%.

Moving on to page 8 where you can see a condensed P&L. I did talk about the relatively weak top line driven by lower volumes and depressed prices. Looking at costs, the cost of sales when stripping out the inventory impact, were down 23%, I think a clear testament to our ongoing focus on containing costs and optimizing the mining operations.

The same trend is clearly visible in off-mine costs in administrative and selling expenses, which are down 26% year on year. The bottom line -- the net loss for the period was at EUR128 million, which included EUR28 million of restructuring-related expenses incurred up to September 30 balance sheet date.

Moving onto a snapshot of pricing on page 9. We are, in this current fourth quarter of 2014, selling coking coal at EUR85 per tonne, which is a slight increase of about 4% on the previous quarter. And we continue to sell thermal coal at a price of EUR54 per tonne. Just a brief reminder, our thermal coal sales are priced on an annual calendar year basis.

On to the key factors influencing EBITDA on page 10. The development was from a negative EBITDA of EUR50 million in nine months to September 2013 to a positive EBITDA of EUR4 million in the same period of 2014. The cost control added just under EUR100 million to the EBITDA; and the improved coal mix, again, 60% of coking coal in the mix, so that added EUR31 million to the EBITDA.

On to the next page where you can see more detail in terms of the two main categories of coal that we are selling. Coking coal revenues were down 7% to EUR312 million, which is a combination of a 12% decline in the price versus a 7% increase in the volume of coking coal sold.

Thermal coal revenues are down 36% to EUR135 million and this is driven solely by the decrease in the sold volumes as the prices were unchanged.

Our coal inventory is approximately 9% above the level of September 2013, at about 600,000 tonnes. Very importantly, cash mining unit costs were down 16% on a constant currency basis. The euro/crown exchange rate did provide a bit of a tailwind there. Factoring out the exchange rate impact, the drop in mining unit costs would be 10% and that, just to remind everyone, is on a production levels down 2%.

And again, our selling and administrative expenses were down 26% year on year.

A picture of our financial position as at September 30, and again, this is prior to the closing of the restructuring. We generated gross cash flow from operations of EUR18 million, paid EUR31 million in interest expenses and spent EUR45 million on CapEx with net debt, again, net debt pre-restructuring, at EUR734 million. And again -- right on the next slide we'll talk about the result of the restructuring, so let's go there.

We're now on page 13. The principal objective of the balance sheet restructuring was to ensure that we arrive at a capital structure, which is appropriate for the business and compatible with our financial performance, given the coal price environment at the moment.

So, in terms of the new capital structure, that is composed of new senior secured note of EUR300 million, a new convertible note of EUR150 million. Importantly, this convertible is mandatorily converting, so even though it clearly carries interest expenses, it will ultimately convert into equity.

The third element of the capital structure is a mandate and termed-out ECA facility of approximately EUR50 million, and a new super senior credit facility of EUR35 million. This is essentially a liquidity credit line. Those are the key elements on the debt side.

In terms of the new capital that went into the business, we have raised EUR150 million in an equity issue, of which EUR90 million was used to tender the old notes that were replaced in the capital restructuring.

And then finally the last piece of the picture is a -- contingent value rights [piece] of EUR35 million, which pays out depending on the future development of coking coal prices going forward.

As regards the key impact of all of this in the short-term, the main benefit, seen from the Company's point of view, is a very significant reduction in cash interest expenses. We have, in a typical year in the past, we would have paid approximately EUR60 million in cash interest. Both the new senior secured note, as well as the new convertible note, has a payment in kind mechanism. In the case of the convertible, it's a discretionary PIK.

In the case of the new senior it's a formula that determines, based on available liquidity, whether interest is paid in cash or whether it's PIK. But I think it's -- to state the obvious, this is a major relief to the Company and it really allows us to go back to focusing on the second major deliverable, which is getting our Czech mining operations to a size and scope that is cash generative even in the current coal pricing environment.

Final note, the restructuring, I really would like to take this opportunity, again, to thank all of the people who were involved, all of the stakeholders, the creditors, the shareholders. I believe that we have arrived at a capital structure, which is a major, major step forward for this Company and really means that we are open for business again.

Moving on to the outlook for -- first of all for the rest of the year. We expect both production and sales in 2014 in the range of 8.75 million tonnes to 9 million tonnes with a coking coal proportion in the mix in the range of 55% to 60%.

We expect to spend less than EUR90 million on CapEx this year. And we expect cash mining unit costs in the mid-EUR60s, excluding the impact of the Paskov mine, with the Paskov mine adding approximately EUR3 to the cash cost number.

Speaking about the Paskov mine, the agreement that we closed with the Government of the Czech Republic is now being taken through a European approval and that process is pending and we will update the market on the outcome as we have it.

Finally, one note on the Debiensko project. I think on -- it's worth reminding everybody that this is a fantastic block of coal. This is close to 200 million tonnes of coking coal. I believe, if not the largest, then definitely one of the largest, European available blocks of coking coal. But of course, it will take a number of years to bring it to production and will require a very substantial capital spend. This is not our priority at the moment. Our priority, clearly, is to continue the excellent work that the team in the Czech Republic has done on cost containment and CapEx reductions, so we are fully focused on our existing Czech operations.

We are evaluating all options there are available to us for the Debiensko project, with the ultimate goal of keeping the optionality and ultimately, over time, finding ways to develop the project.

We clearly cannot just look at the immediate few quarters; we need to think long term and that's what we are doing. But the main message for you on Debiensko this morning is that we will not be spending material amounts of money on developing the project in the near term.

Just a very quick note, in closing, on our thinking for 2015. We are still in the process of budgeting for the calendar year 2015, so I do not really have hard numbers for you, other than to say that we expect production in the range of 7.5 million tonnes to 8 million tonnes in the calendar year 2015 and our budget is going to be based on an assumption that coal prices will not rise, whether it's coking coal or thermal coal prices.

Very final slide, and just to remind everyone that our long-term strategy still stands. For those of you looking at the picture, I think we have made major milestones in delivering on the blue bubble in front of you; the optimization of current operations.

Clearly, the market is still depressed and so we will need to continue what we have been doing. We will continue the attack on costs and CapEx in 2015. But the other two pillars of our strategy, namely to increase the amount of coking coal supplied to the European market, as well as ultimately becoming a one-stop-shop for European fuel customers, those remain very much standing. But the first step, now that the balance sheet has been appropriately addressed, the first immediate step is to get our Czech mining operations to be cash generative at current prices.

That concludes our key messages this morning and I'd like to hand over to the operator for questions and answers. Sergei, please?

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). Michael Posnansky, M&G Investments.

Michael Posnansky - *M&G Investments - Analyst*

I was just wondering, what do you think you can do for costs in 2015 or what are you telling your mines in terms of putting in their numbers at this budgetary process? I realize that it's not complete yet, but just some guidance on what you're asking the mines to do, would be interesting.

Also, I remember when you came out with the trading statement, you said that there had been some geological issues in the third quarter. I was wondering if that had any impact on your cost base that we should be aware of.

And then also on the inventory side, should we expect the same sort of movement in the fourth quarter versus the third quarter as we saw last year? Obviously, there was a large sell-down of inventories in that quarter and what should we expect this year?

And then finally, again, going back to your budgetary process and what you're asking the mines to do, where should we expect CapEx to be for 2015? A wide-ish range would be fine if you can't give anything more precise. Thank you.

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

Thank you for the questions, Michael. On costs, the largest operating expense item in our P&L is personnel and I'm afraid we'll have to do more on that front. But there are other items such as maintenance, which we are addressing, such as mining material, this is mostly steel that goes into the underground drivage and actually overall, the drivage expenses are one of the items that we will be addressing.

Just to give you a data point, okay, in a normal year, historically we would have spent or we would have built about 50 kilometers of underground tunnels. This number is going to come down to some extent.

On the geological difficulties, I'm afraid that operating mining, 1 kilometer or more underground, is just a constant battle with the forces of nature. This is largely unpredictable and very difficult to manage. I'm happy to say, though, that this has not had a major impact on the costs recently.

On inventories, inventories are now, as we speak, slightly higher than the 600,000 tonnes you see at the end of September. We actually think that the inventory balance is quite low.

Our reduction in sales, year on year, is not driven by the market, it's, in this case, purely a function of production. Any tonne of coal that we mine is already sold by the time it comes to the surface and so I think the straight answer is, there is not going to be a dramatic change in the inventory balance.

We might end with inventories just slightly above the September balance, partly just to be ready to manage any potential unforeseen production issues at the beginning of next year.

Michael Posnansky - *M&G Investments - Analyst*

And on CapEx for next year?

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

Yes, CapEx. CapEx will be substantially lower than this year. I really am not able to give you a firm number at this moment, the budgeting process is just being finalized and we will provide appropriate guidance early in the new year.

Michael Posnansky - *M&G Investments - Analyst*

Okay, thank you.

Operator

[Dio Dudunakis, Genovare]

Dio Dudunakis - *Genovare - Analyst*

On the incident on the [Jaluka] incident, could you explain us a bit more what actually happened because I don't think it was clear from your previous answer, like, what was exactly the incident?

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

Thanks for the question. Just to be clear, there wasn't an incident that would have any major impact. What happens is, as you mine in relatively deep areas, and in areas which -- where in the floors above there has been a lot of mining going on in the -- this Company has been mining for about 200 years. What happens is the pressures of the rock above the mining areas occasionally release themselves and you have tectonic events, you have rock bursts and these things are our daily bread.

So, just to be clear we didn't have a single catastrophic event, we had a number of occurrences that caused some trouble in production, but there wasn't an accident.

Dio Dudunakis - *Genovare - Analyst*

I understood, thank you for the clarification.

Now on your coupon on the new convertible notes, what is the intention of the Company for the first coupon, is it to pay it in cash or to PIK?

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

We will make that determination based on the near-term outlook at the time of the coupon payment, that's yet to be determined.

Dio Dudunakis - *Genovare - Analyst*

Understood. Okay, that's it, thank you very much.

Operator

(Operator Instructions). Michael Posnansky, M&G Investments.

Michael Posnansky - *M&G Investments - Analyst*

Just a follow up from me. On the labor side of things, are there any negotiations planned with the unions about wage increases for next year and when should we expect that? Just wondering on that side of things.

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

Yes, understood. There's an existing valid labor collective agreement, which provides for inflation-related wage growth and also covers things like headcount reductions, etc. So at present there is no need to negotiate with the unions.

Michael Posnansky - *M&G Investments - Analyst*

And when does -- can you remind me when that expires?

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

It's a three year agreement that we entered into last year, in 2013.

Michael Posnansky - *M&G Investments - Analyst*

Okay. So there's nothing further that you can do with the unions during this period on costs?

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

No, it's an agreement between the union organizations and the Company. I'm just saying that it provides for what we need to do in the near term.

Michael Posnansky - *M&G Investments - Analyst*

Okay, thank you.

Operator

Dio Dudunakis, Genovare.

Dio Dudunakis - *Genovare - Analyst*

Thank you, just a couple of follow ups. On the mining cost this quarter was not -- the development was not as impressive as in the previous two quarters, is that mostly due to the lower production or is it something else?

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

No, it's -- that's --you've answered your own question. It's -- the mining unit cost, obviously, is a function of production and because of the production decline, the unit cost of production was not great. But if you look at the costs in absolute numbers, and again, I would refer you to the OFR, which has all the detail, you can see what's happening in the actual cost numbers and I think we've done a good job there.

Dio Dudunakis - *Genovare - Analyst*

Yes, completely understood. I think it was a couple of months ago where (technical difficulty) NWR mentioned the potential of decreasing costs by consolidating some underground mines. It was actually just a -- it appeared in Bloomberg also, was that something official or --?

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

Yes, it's one of the things under consideration, yes, that's correct.

Dio Dudunakis - *Genovare - Analyst*

Can you explain that to me a bit, because I don't have an engineering degree but --

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

I understand. Well, it's really simple; we are operating four mines at present, each mine is a -- even though they all are within one single legal entity, OKD, our Czech mining company, they still operate to a large degree as separate organizations. So I think you can see the potential of merging some or all of these organizations and the impact on -- especially the off-mining costs, that this would bring. So this is one of the things that are under consideration at the moment.

Dio Dudunakis - *Genovare - Analyst*

Okay, so that's on the SG&A mostly cost?

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

Correct, yes.

Operator

(Operator Instructions). As there are no further questions I would like to turn the call back to the speaker for any additional or closing remarks.

Radek Nemecek - *New World Resources Plc - IR*

Thank you, Sergei, and thanks, everyone, for joining the call. If you have any further questions please contact our Investor Relations department. Thanks, bye-bye.

Marek Jelinek - *New World Resources Plc - Executive Director & CFO*

Thank you for taking the time. Bye-bye.

Operator

Thank you, that will conclude today's conference call. Thank you for your participation, ladies and gentlemen, you may now disconnect.
