

SEGEZHA GROUP

CONFERENCE CALL DEDICATED TO SEGEZHA GROUP 6M 2021 IFRS & OPERATING RESULTS

Company: Segezha Group

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Participants:

- Mikhail Shamolin, Chief Executive Officer
 - Rovshan Aliyev, Chief Financial Officer
 - Vladimir Vinogradov, Vice President for Strategy
 - Elena Romanova, Head of Investor Relations
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Operator:

Ladies and gentlemen, thank you for standing by and we would like to welcome you to Segezha Group six months 2021 conference call. At this time, all participants lines are on listen-only mode. The format of today's recorded call will be a presentation by Segezha's management team, followed by question and answer session. So without further do, I would now like to pass the line to Ms. Elena Romanova, the Head of Investor Relations. Elena, please go ahead. The floor is yours.

Elena Romanova:

Good morning, everyone. I'm here with Mikhail Shamolin, the CEO of the company; Mr. Rovshan Aliyev, who is the CFO; and Mr. Vladimir Vinogradov, who is Vice President for Strategy.

Elena Romanova:

Before we begin, I remind you that you can download the presentation at our corporate website at investor section, and in presentation, you may use our forecast and forward-looking projections later for the disclaimer. And following prepared remarks, this morning, we will turn the call over for your questions. Now, let me please pass the floor to Mikhail Shamolin. Mikhail, please go ahead.

Mikhail Shamolin:

Yes. So ladies and gentlemen, good afternoon. Welcome to Segezha first quarterly investor call. I have not really prepared a speech for today because the numbers pretty much speak for themselves. You've

seen the results. I think they're pretty decent, and what I would propose to do is Rovshan Aliyev will now make a presentation with more detailed comments on financials. Then, Vladimir Vinogradov will speak a little bit about our further strategy and investment projects. And then we will jump into Q&A where the whole team, including myself, will be able to answer any questions that you have. With that, please Rovshan, start the presentation.

Rovshan Aliyev:

Thank you, Mikhail. Good morning ladies and gentlemen. We're delighted to present you our first financial results for the H1 after going public. The financial performance have been strong. Our revenue have grown year-on-year by 57%. Our EBITDA have more than doubled by 112%, year-on-year. And most importantly, our marginality grew 11% year-on-year, to the 31%.

Our net profit have rose dramatically from the loss of 2 billion last year to the 7.6 billion this year. This is driven mainly by the strong operating results as well as absence of the one-off loss from the FX evaluation of the debt last year.

Our net debt have reduced tremendously in the period by 42%, mainly driven by a strong generation of the cash flow, operational, as well as proceeds from the IPO.

Our CAPEX, which includes maintenance, growth, as well as M&A activity, have accounted for the 13.2 billion rubles.

Our operational results across the board and the segment, we have been increasing our production volumes over the last year. And this year, with exception for the paper production, we have been operating at a 100% of our net capacity.

On the paper, while in the H1, we have been at the same level as the previous year, we are going through the plant modernization of the main Segezha Pulp and Paper Mill, which we are, resulting in small reduction in the production compared to the previous year.

On the packaging, we have successfully launched the two new converting lines, and we're in the process of installing the two new lines and increasing our packaging production both in Russia, so that's in Europe. Our sawn timber production facility have been at 100% of the utilization across the board in all five factories. Our plywood have been at the 100% utilization, and more importantly, are shifting towards the more high marginal products as well as for the pellet.

For the glulam product, we have reached 100% of the utilization of a brand new glulam facility which we installed last year. So the gluing production has significantly increased year-on-year, as well as we are reaching 100% utilization on a brand new CLT factory.

Let me give you a glance on the harvesting which is, by far, the heart and soul of our company, and the key strategic advantage. We have seen over the period, as the pricing have been quite positive on the market as well as... I'm sure you have seen as well, a lot of industrial players have spoken and commented on the inflation.

In our case, we have remained loyal to our highly efficient business model which includes up to 80% self-sufficiency in the wood, and that is a key ingredient which allowed us to almost don't have any inflation indicators and enjoy higher margins. We have further increased harvesting volumes by 6% year-on-year. At the same time, we're continuing our operational efficiency and decreasing the cost of our timber harvesting by 4% year-on-year.

So looking on the pricing and on the market, the pricing condition have been positive on almost all products. We have seen a robust recovery on the paper market which by the end of Q2, have been closing to the prior to the COVID pricing or average of industrial cycle.

In our vision, we see that the prices in Q3 are reaching the prior to COVID industrial averages, and the fundamentals and the demand remained strong.

On the sawn timber, the prices have been increasing tremendously from the Q1 to the Q2 by 44%, as this was mainly driven by the high construction activity across the world as well as the high demand in all the major regions. The same pricing and the same demand projection are continuing to the Q3. And in Q4, we're expecting some seasonal slow down.

On the plywood, the combination of us focusing on a more high marginal product, as well as positive market dynamics, have driven the price up by 32% in Q2. In Q3, we are anticipating a further price increase as the market condition remains very strong. And in Q4, some seasonal reduction.

On the glulam product, the segment that have a longer lead time in contracting, usually six to nine months, the recovery of the prices have been at a lower pace. However, in Q3, there would be a significant increase as we're renewing our contracts.

Now, going into the revenue. Our revenue, year-on-year, have been mostly affected by the increase in price changes, as we are exporting ca 73%. Therefore, we are a beneficiary of the slightly weaker ruble, and our FX added a 2.8 billion ruble into the revenue.

On the revenue bridge by segment, the main driver of the revenue increase have been forestry management and woodworking, and this is mostly thanks to the increased volumes of the harvesting as well as high prices on the sawn timber.

The paper packaging, plywood and boards, and laminated wood products, all also accounted very nicely into the general increase.

So look at the OIBDA drivers. All this, the revenue have been the biggest driver and that is a combination of the high volumes which we introduced in 2020, as well as in a positive pricing dynamic. We have seen a very little inflation indicators, and our cost of goods sold was more related to the volume.

On logistics, however, we felt the same effect as every global player. The logistic costs indeed have increased tremendously and remaining at this level. As harvesting costs have been under strict control and the same year-on-year. As a result, the OIBDA have grown tremendously. The main drivers by the segment have been again forest management and woodworking, followed by the plywood and boards, laminated wood product, and paper and packaging.

Going now within the detail of each of the division, and giving you an insight of what is happening to key projects and the key highlight. On the paper and packaging, the revenue growth year-on-year by 8%; and the EBITDA grew by 12%. The EBITDA annual revenue of the division have been affected by the plant and maintenance shutdowns on the Segezha Pulp and Paper Mill, and this is related to our modernization plan which we are announcing and performing successfully this year, which will increase the production by 25,000 next year.

We also kick-started the modernization of the Sokol Pulp and Paper Mill. It is an entirely brand new paper-making machine with an investment of around 11 billion rubles and planning to be completed by the end of 2022.

On the key highlights, we have expanded as well the geography of our sale, now focusing on Americas and Latin America. We also have launched, as part of the first wave, modernization of Segezha Mill. This is a brand new product which is the white marker paper, which will be most used for the internal packaging consumption as well as for the external market for sale.

Looking at forestry management and woodworking segment, we have been consistent in our production volumes year-on-year. The utilization rates have been flat, close to 100%. As a result, the revenue on the

positive pricing have grown 49% and EBITDA have shown the same effect and increased more than four times.

We kick-started the modernization of Onega mill and as well as Lesosibirsk mill. Both projects are linked to increase the production, but at the same time, increase of optimization, decreased labor cost, and significantly decreasing a total cost of the production by 30%. So both projects have started at the end of Q2, and we will give an update under the timing of them... when they're planning to go live. The key highlight as well, as I mentioned, was an increase of the harvesting in the division.

Looking at the plywood and board segment, we have continuing our strategy focusing on more high marginal products, so we introduced the new product like ClearPly, Ecofloor, and Plyform. We have expanded our customer base across the modern 20 more new industrial customers.

The revenue have grown by 49%. EBITDA have grown more than two times. We have kick-started the project of expansion of capacity in our existing plywood mill by 33%, and as well as continuing with our project coming live by the end of 2021, of Galich plywood mill for 125,000.

On the laminated wood product segment, we have, as I mentioned, increased and have reached 100% utilization of the new glulam line, and that, year-on-year, the glulam production have increased tremendously. The housing and the home kit have been also in high demand for both internally, in Russia, as well as in externally. And we'll have... expanding our production line from the CLT. As a result, there's a division and we separated the division, and reporting now as a separate, grew by 60%, and EBITDA grew tremendously by one billion rubles.

We continued our construction of the pellet manufacturing and boiler in Sokol DOK which are planned to come live by the end of November of this year. This will add 65,000 tons of pellet as well as make the production facility a zero-waste production facility and efficiency in energy, increased efficiency in energy.

We're also in a plan of constructing a new glulam product mill in Segezha that is a 240,000 cubic meter of glulam and 100,000 tons of pellets. We are, as of now, in a deep phase of the basic engineering and the preparation, and we'll kickstart the project by the end of 2021.

The CAPEX, for the H1 of 2021, have been 13.2 billion rubles and increased year-on-year by 65%. The CAPEX of 13.2 billion have split on six billion in the gross CAPEX on the projects I have mentioned on the previous slide. RUB 2.5 billion, it is a maintenance CAPEX for the existing operation of the facilities, and the 5.7 billion are spent on the M&A acquisition which we'll be mentioning in a little bit in a greater detail.

On the working capital, we have improved year-on-year in a turnover date of receivables tremendously and considering the increase of the monthly revenue by more than 45%. We have kept in ruble terms, the account receivable at the same level, which is a significant improvement.

Traditionally, in H1 of every year, we are increasing the working capital with a larger result of the wood which is harvested and prepared more in the winter period of time, and then you reduce over the end of the year. So our target, that by the end of the year, despite the increase of the volumes and the revenues, we will even further decrease operational working capital.

On the free cash flow, operating cash flow generated by the operations have been 4.3 billion rubles which is strong dynamics by the OIBDA, changes in the networking capital and income types, and one of the expenses on the IPO. At the same time, we have continued our significant investment into the expansion of the company as well as net free cash flow have been negative at 8.9 billion.

At the same time, despite all that, we have continued and reduced our leverage. And our leverage at the end of H1 have resulted in 1.2. We are consistent with our approach and despite all the increase in the

investment into the expansion, we have a plan and are committed to maintain our leverage at a promised level of 1.5 to 2.

Our debt payment schedule as procurement agreement, quite beneficial for us and does not require a major investment in the next few years. However, we have repaired some old and expensive loans, and now are looking at opportunities of doing refinancing and some other existing loans. So on the right side, that is a potential repayment schedule maybe for the existing loans by giving the cash flow as well as the investment activity.

At the end, I would like to also mention that yesterday, we have received a public rating. Our first rating on the ESG, have been very positive which is a confirmation of our strong commitment into the ESG. The rating is 21.4, which put us on the same, as an industry average, across the globe in pulp and paper, and forestry industry, and significantly better than metal and mining, or oil and gas, or other production within Russia.

With that said, I will pass the floor to Vladimir to give you an update on the strategy.

Vladimir Vinogradov:

Yeah. So first of all, on slide 16, let me remind you now three strategic areas, directions which we're following. The first is further expansion of the forest lands. The second one is the implementation of the value accretive investment project in the product processing area. And the third one is the strong commitment to best ESG practices and standards. So we continue to delivering on all these three areas.

In the next slide, you can see the details on the coming acquisition of NLHK in Krasnoyarsk region. The deal is in the very final stage which is planned to be closed in September of this year. With this acquisition, first of all, we are getting additional to the two million cubic meters of allowable cut in the Krasnoyarsk region, and by this, we will increase our AAC by another 20%.

Also, on top of this, the NLHK excess of forest resources which is very beneficial for our existent LLDK. So in total, all these two plants will be fully self-sufficient with the wood resources after the acquisition. The NLHK is very modern. So next year, we expect significant revenue and profit from the production itself. And on top of this, we expect to receive significant step up with the optimized wood logistics, and so on, and so on.

On the next slide, you can see all the strategic projects which we looked at and approved within the strategy of Segezha Group. As you can see, 6 out of 14 of the project will be implemented this year and will deliver significant additional OIBDA in the year of 2022.

The industrial production line is already implemented and is in the very final stage. Also, I would like to mention that the Galich plywood contract is also in their final stage and will become operational also this year. All the projects are on time and on budget, and we expect to continue following the successful implementation of all the projects.

On the next page, you can see the details of the big projects we are considering at the moment which is Segezha West. The project is aimed to construct brand new greenfield projects in Karelia for 1.5 million ton of pulp, both softwood and hardwood. The decision on this project is not made. We continue the engineering, and the basics, and the preparation for the construction at this moment. So we expect to get all the permissions next year and to put this project for the approval of the Board next year.

So far, we're very positive about this project. It is planned to realize the project based on the project's financing scheme. The total budget of the project is around 150 billion rubles, where the contribution of Segezha Group will be around 20 billion rubles. That's the current status of the biggest projects we're considering at the moment.

With this, I'm finalized with the strategy update and ready to open the session for the question.

Operator:

Thank you very much. I will now be moving to the Q&A part of the call. If you're dialing via the telephone, please press star two on your keypad and wait for your name to be called; that's star two. If you're dialing via the web, you may also ask a voice or a text question. We'll now give a few minutes for the questions.

Thank you. Our first question comes from Mr. Anton Fedotov, from Bank of America. Please go ahead, sir.

Anton Fedotov:

Hello. Thank you very much representation. Congratulation on the great set of results. I have two questions.

My first question relates to the Segezha West project that you just mentioned. You said that Segezha, itself, is planning to invest just 20 billion rubles in that project, while the total CAPEX is 150. So how are you going to finance most of the CAPEX, the remaining 130 billion?

And my second question is regarding your effective tax rate in the first half of this year. On my calculation, it's 22%. While at the guidance, I think, from the company, was about 15% corporate income tax rate. What number should we expect for the whole year? Thank you.

Rovshan Aliyev:

Yeah. Thank you for your question.

Mikhail Shamolin:

Rovshan will answer the question on taxes, and myself will answer the question on the Segezha West finance structure. Rovshan, go ahead.

Rovshan Aliyev:

Yes. On the taxes, just to give a clarification. In H1 of this year, we have been doing some restructuring, intragroup, which resulted in a higher tax rate. At the H2, we will be normalizing to our guided levels.

Rovshan Aliyev:

And on Segezha West, Mikhail will comment.

Mikhail Shamolin:

Yeah. On Segezha West, we plan that around 40 billion rubles will be consolidated as equity; out of which, 20 will be supplied by Segezha, and the 20 will be provided by our banking partners. It's major Russian banks, big names that everyone knows. So we will consolidate equity and then we'll attract debt against that equity in a projects-finance-type structure. So basically, this asset will not be consolidated with Segezha until the completion, and will be operated and run as a separate project.

But once the factory is launched, we'll buy out our equity partners at a predefined rate, and then consolidate both the debt and the EBITDA of this new venture if this project, of course, if we go ahead which is subject to regulatory approval, eco approval, all the technical specs approval, and all the steps

that need to be taken in order to start a project like this. So we expect basically decision, go or no go, to be done in 2022.

Operator:

Thank you very much. Our next question, from Mr. Alexander Vengranovich, from Renaissance Capital. Please go ahead, sir. Your line is open.

Alexander Vengranovich:

Yes. Good afternoon, gentlemen. My question relates to the outlook for the rest of the year, so basically your comments regarding the stable and basically improving pricing environment. What I have thought on the financial results for the full year, this year, obviously, we might have some kind of own expectations, but I'm just trying to understand. Do you expect that basically the full amount of the production which you are planning to do this year across all the different product lines, you will be able to sell it at the projected prices and whether that will be a good indication of the potential revenue for the rest of the year?

And the second question here, obviously, you had a really strong OIBDA margin, especially in the second quarter. So I'm just trying to understand whether the general cost inflation will kind of have some sort of a delayed impact on the second half, '21, profitability or should not we expect any kind of a visible negative impact of the cost inflation on your profitability side despite the improving price environment for the main product. So basically, the question goes down to two lines: what sort of revenue are you expecting for the second half, '21, if you can share, and what sort of profitability you can also guide us on? Thank you.

Mikhail Shamolin:

I will have the revenue and the market side, and Rovshan will comment on the cost side. Basically, obviously, we cannot give you any kind of forecast or guidance legally. We're not allowed to. But revenue side is basically driven by two factors, which is production volume and pricing. On production volume, we don't expect any major repairs or any major slow downs until the end of the year. So the production should remain pretty much the same as it was.

And as far as pricing goes, so far, we have only seen slow down in the solidwood because the prices have skyrocketed in the first of half of the year because of the United States. But this slow down and price correction should not dramatically impact our revenue numbers because for Q3, the contracts have all been signed and the product has been pretty much sold. And there maybe a slight price decrease in Q4, but we don't expect any substantial sort of drop in numbers.

On the paper side, the prices actually continue to grow slowly, but steadily; so we don't see any slow down. And on plywood and glulam, the prices have been stable and we don't expect them to drop until the end of the year; even though we can't really see exactly what the prices will do beyond sort of three to four months period because the markets are very diverse and it's very difficult to exactly pinpoint how the price will behave. But we believe that we'll live in a stable price environment at least until year end.

And now, Rovshan, will give you more details on the cost side.

Rovshan Aliyev:

Yeah. So on the cost side, and let me just reiterate here that the key competitive advantage that we, as a group, having is that 50% of all costs that we incurred is related to the cost of the raw wood and the

raw material. And that cost, we are actually in full control of that cost. And as I have mentioned in our presentation, we have actually a decrease of the cost of cubic meter that allows us to control the 50% of our cost and our destiny in our hand.

The second portion of it is our labor cost which accounts about 25% of our total cost. And the labor cost indeed does inflate every year, but at an average rate of the inflation in Russia. So overall, given the major cost line is under control, we do not anticipate any major swings between H1 and H2 in a cost structure. Our cost structure... and that's the beauty of our company, and it is in our hand, and it is fully controllable.

There is some position that is obviously we are buying from the open market or at logistic where we have participated in a global industry, but those costs, in total cost of the structure, are not big enough that even the big swings within them can have an impact on the group. So the marginality of the group, I expect it to be at the same level or even higher, obviously, depending on how the pricing will come out just what Mikhail had mentioned before.

Alexander Vengranovich:

Okay. Thank you. That's good.

Operator:

Thank you very much. Our next question comes from Anna Antonova, from JP Morgan. Please go ahead, ma'am. Your line is open.

Anna Antonova:

Yes, good afternoon. Thank you for the presentation. Couple of questions from our side, and I'll ask them one by one for simplicity.

Anna Antonova:

First, on Segezha West project, could you please remind us what is the strategic rational for going ahead potentially with this project? It seems you already have many other projects in the pipeline, including the recently acquired [inaudible 00:35:06] complex. So could you please shed some light on that?

Mikhail Shamolin:

Okay. Of course, thank you for the question. Segezha West is a highly valued project which will allow essential to double Segezha Group in size. The expected OIBDA from Segezha West will be between 45 to 50 billion rubles a year.

And the strategic rational is to build a modern plant based on the low cost of raw material which we achieved in Karelia and surrounding regions. And also to expand our line of products from just sack paper to market pulp and to a bleached pulp which we do not produce now. Bleached pulp is a huge market. Internationally, it's more than 55 to 60 billion dollars a year. It's growing. Even though it also moves in cycles with pricing, but given the cost point that we would be able to achieve with Segezha West, we will be making money pretty much regardless of the cycle at any point.

Even in the lowest point of the cycle when the pulp prices drop to about 500 euro per ton, our marginality in Segezha West will be about 200 euro per ton, and of course, much higher when the prices are high. And on the average cycle pricing, our marginality will be above 40% in this project and the total IRR of the project is above 25% in hard currency. So basically, even though it's a big project and there are risks associated with the construction, and the implementation, and timing, and everything else, but

it is well worth it if the project is well structured and is sound from the engineering perspective. And again, even though Russia has a huge benefit of a low resource, low raw material prices, it did not have modern pulp mills.

And also, ESG topic is very important because the existing Segezha mill was built quite some time ago, and even though we are modernizing it, it's still not the same as to build a brand new factory using the latest available technology.

Anna Antonova:

Understood. Thank you. Do we see any of your domestic competitors planning or contemplating to construct similar pulp and paper mills in Russia? Is it fair to assume that you maybe accelerating the execution of this project to just have a headstart versus your domestic competition, or you don't see any other potential competing projects in Russia for the execution over the next few years?

Mikhail Shamolin:

Well, we're really not competing that much with our Russian counterparts. I mean, our main competitor... but not even competitor. It's like a company working in the same industry as us, which is Ilim Pulp. Ilim is quite active in constructing new paper machines, and pulp and paper mills in Siberia, and they have been successful in doing so.

Besides Ilim, there had been many projects announced over the last 10 to 15 years, but not a single one was launched or complete. So basically, Segezha West, from our standpoint, is the most kind of pragmatic and realistic project to be done in Russia.

And with that, again, we're not competing with the Russian companies. We're competing with the global companies. And a lot of capacity has been added over the recent years in Finland, but mainly in South America. South America, based on the [eucalyptus 00:39:33] which is a tree that grows for about 10 to 15 years, and can be planted to grow and then used in the pulp and paper production, so the cost is very low.

But the South American pulp is not as strong as the softwood pulp which is our competitive advantage. And there's actually two different segments in the market: the hardwood pulp which is South American eucalyptus, and the softwood pulp which is Canada, Finland, Sweden, and Russia.

And Russia has the most kind of unused softwood raw material base in the world, globally. And we do not want to compete directly with the South Americans. They will be supplying the hardwood side of the pulp, and we will be supplying the softwood side for the global market.

And given that the market, globally, grows by 2% to 3% a year, that means that each year, about a million ton of new capacity need to be added somewhere in the world, globally. And in this capacity, it's not added, then the prices grow exponentially because essentially demand for pulp is very high and there are no alternatives. There are no substitutes.

And actually, quite the opposite, paper is now replacing plastic and paper mills pulp, right? So we don't see that this project will suffer from competition that much.

The most important thing about this project is wood and construction risks, budget kind of runoffs, and timing. Those are three things. If we can build this Segezha West plant on time and on budget, I think the success is more guaranteed. There are no apparent market risks that we see.

Anna Antonova:

That's very encouraging. Thanks. Final question on Segezha West. So what kind of net impact on your ESG group credentials would you expect from this project? On the one hand, the plant will utilize much more modern best available technology versus your current mills. But at the same time, as we understand, the technology for bleached pulp is a bit less environmentally friendly than for unbleached production. So how should we think about this?

Mikhail Shamolin:

Well, even though the new plant will be bigger in overall, we will decrease our emissions five times, fivefold. Even including the bleaching process.

And by the way, we will use the oxygenated bleaching method that does not use molecular chlorine which is going to be the most environmentally unfriendly thing. So the plant is going to be actually much, much better than what we have today.

Anna Antonova:

All clear. Thanks. Second question is in terms of CAPEX. So looking at the slide 18, with all the projects in your pipeline, do you confirm your pre-IPO total CAPEX guidance 4 to 7, 21 to 25 of total 32 billion rubles, or with all the recent news flow and strategic updates, we can expect to see the upside risks to this number?

Mikhail Shamolin:

That is to Rovshan and Vladimir to answer.

Rovshan Aliyev:

Yeah. Thank you. So on a CAPEX, we anticipate our H2 CAPEX will be the same, in line with H1 or a bit higher, which would be close to what's our commitment during the prospectus time.

At the same time, let me remind that we have mentioned, and very clearly, that if the market condition moved favorable and we, as a company, will significantly [inaudible 00:43:40] our anticipation was and the cash flow generation. We will be accelerating some of the projects. Now, if further down the line, meaning in a short period of time, it will be more increase of the CAPEX. However, there was no effect on the cash flow and that is exactly what is happening as of now.

Anna Antonova:

All clear. Thanks. Final question from our side, on the regulatory front. So do you expect any tax increase for the Russian forestry sector receptor in a way, similar to what is currently being contemplated for the Russian mills and mining sector?

Rovshan Aliyev:

Let me answer that question as well. The short answer is no. We're not anticipating, but let me reiterate a bit in detail why it's not happening. The forestry industry, in general, are significantly underinvested. And over the last 40 years, really have not been any major investment into the increase of the production in large scale.

And the government identified that the Russian forest have a huge potential and significantly undervalued from what it can bring. However, to unlock this potential, the industry needs to have a significant investment in the next 10 to 15 years. So compared to the metal and mining which have

already done that investment and now are generating a large cash amount, so they are more looked by the government as something that can be more taxable.

The forestry industry is still 10 to 15 years ahead of us, requires additional investments. So government understands it very well, and that's why the forestry industry, in general, or vice versa, are supported by the tax subsidies and the tax breaks to make the investment more attractive. And that's to answer your question.

no, we're not anticipating any increase in tax rates.

Mikhail Shamolin:

And let me add to what Rovshan has said. Basically, what happened with the steel makers in Russia, is that a number of government-planned construction projects, large infrastructure developments that the government has planned out to 2021, were severely overbudgeted because of the growth for the price of steel, right? So the government could complete their commitments to finalize the investment project and sort of the old... were short of financing and that's why they said, "Okay. Let's put export tax on the [inaudible 00:46:30] so we can lower down the prices and complete the government-funded projects."

And of course, wood is also a part of construction, but to a much, much smaller extent in the global kind of construction developments because it's only used in kind of buy side applications. And more over, in Russia, the growth of prices for sawn timber was only relevant to the high moisture content timber which is about 22%, which is a typical Russian market because the product, the sawn timber that we produce and export, has less than 22% humidity in it, and therefore, it's not a local Russian market product and imposing export tax on sawn timber will not decrease timber prices in Russia at all. It's just basically to reduce the export revenue, and that's why there's no point, and we don't see why the government would impose those taxes on the forestry industry on top of what Rovshan said about the investment needs and needs to process more of the wood internally.

Anna Antonova:

All clear. Thank you for the comments.

Operator:

Thank you very much. Our next question comes from Mr. Igor Goncharov, from Gazprombank. Please go ahead, sir. Your line is open.

Igor Goncharov:

Yes, thank you very much. Congratulations on excellent results. Just a couple of questions on Segezha West and on dividends. On Segezha West, I just wanted to clarify. You mentioned that you expect some regulatory and technical products to come by the end of the year. Am I correct in understanding that from economic standpoint, you don't see basically any questions about the project?

And from economic standpoint, you pretty much made your mind in relation to implementation of this project. And the only probable possible restrictions or obstacles are the regulatory and technical ones, and those are... if you successfully pass through those, you would go ahead with the project? That's number one.

Number two is I just wanted to clarify the timeline. You mentioned, if I heard it correctly, that you may start in 2022 and it might take 25 years to complete the project. But also you said, if I heard it correctly, that you target the end of 2024 to complete the project. Is it really the end of 2024, because the timing does not work out exactly? And that's on Segezha West.

And on dividends, I just wanted to clarify... you indicated you need [inaudible 00:49:42] the target of 3 to 5.5 billion rubles to be paid in '21, '23 annually. Can you disclose any specific plan or steps that you envision, in particular, this year to meet this commitment? Thank you.

Mikhail Shamolin:

Okay. I will answer the questions to Segezha West, and Rovshan will comment on dividends.

On Segezha West, yes, you are correct. We don't see economic risks in this project. We see construction, and kind of implementation and budget risks in completing such a large and complicated project in Russia. But by now, we have already done a number of successful construction projects, new mills, new plants. And we're fairly confident that we will be able to manage those and complete Segezha West on budget and on time.

As far as timing is concerned, the best benchmark that we're looking at right now is the construction of a similar mill by Metsa Group which is a large Finnish pulp and paper company in [inaudible 00:51:07] which is commissioned in 2017, and it took them two-and-a-half years to build, right? So 2.5 years is kind of the best benchmark that we're looking at right now.

If we make a decision by December 2021 or early 2022, and order equipment and sign contracts with the major equipment suppliers, it will take roughly from 12 to 24 months for different parts of equipment to be manufactured and delivered. Of course, the construction, we will start immediately and we'll start installing the equipment already at the end of 2022, beginning 2023. And the last equipment will come at the end of 2023. So we'll have the whole 2024 to install the equipment and start kind of running the plant.

Rovshan Aliyev:

Yes. On the dividends that we clarified, we are going to be sticking to our dividend policy. As per our dividend policy, we mentioned it's going to be three to five-and-a-half billion rubles. And at this point of time, it's clear for us that is going to be at least five-and-a-half billion rubles, for sure. You mentioned the calendar 2021, meaning it's going to be during Q4 of this year.

Igor Goncharov:

Okay. Very clear. Thank you very much.

Operator:

Thank you very much. Our next question comes from Ms. Anna Kurbatova, from Alpha Bank. Please go ahead, ma'am.

Anna Kurbatova:

Yes, good afternoon. Thank you very much. Again, congratulations with very strong numbers. Let me also continue the topic of your dividends. And my second question will be regarding your leverage targets.

So you confirmed your dividend targets that you will be paid, formally, based on the financial results of the last year, 2020. And if we look further into 2021, that we are already at the end of August, is there any probability or are you considering any possibilities, yes, that you might potentially pay these interim dividends for 2021, or you will likely to stick to one-time annual payment? What's your options and preferences? Thank you.

Mikhail Shamolin:

Rovshan, please?

Rovshan Aliyev:

Yes. Let me answer this question. So we will be distributing our 5.5 billion from the income from the previous year, so retained earnings so called, and that is our current plan.

Now, the earnings that we made from 2021, if your question was nicely asking, we will be distributing some interim for 2021, which means the cash cost or the cash dividends for the year will be higher than 5.5 billion. I cannot comment at this point of time, but possibility ...

Anna Kurbatova:

No. Maybe I [inaudible 00:55:04] not very clearly. I'm asking about your potential possibility that you split your annual payment into maybe two parts. So you may pay potentially interim dividends for 2021, still in the calendar year or the beginning of the next year, or you will be much more comfortable with one-time payments that maybe in-

Rovshan Aliyev:

I see, yeah. This year, we are paying it in Q4 and it's going to be one payment at the end of the year. For the next year, we will be moving to the same annual dividends, meaning the dividends will be paid two times a year.

Anna Kurbatova:

Yeah. That's clear. Thank you.

Anna Kurbatova:

And my second question is regarding your leverage target. At the IPO, the guidance was the two-point not exceeding the leverage of... level of two times [inaudible 00:56:06] OIBDA. And during your speech, you indicated from 1.5 to 2. And I'm asking whether it's the short-term targets. So until the end of the year, or you indicated more like a medium term target?

And if market conditions continue to be strong, can you deliver well in terms of OIBDA and operational cash flow? Should we expect both, the acceleration of CAPEX and balancing [inaudible 00:56:43] opportunities, you will still have to decrease your leverage. So what's the balance of your targets here between CAPEX and the leveraging? Thank you.

Mikhail Shamolin:

Let me answer this, Rovshan. The way we think about it is that on one hand, it's good to have low leverage. On the other hand, if we have too low of a leverage, we are not aggressive enough, and we are not growing fast enough, and we're not capitalizing on the opportunity that market is presenting us with, right?

Mikhail Shamolin:

When we said in our guidance, in the IPO, that we would prefer to have a leverage at 2.0 or below, we stick to that statement and that is kind of our strategy going forward. However, if we see that the financial results grow quicker, then it was anticipated in our strategy, and the markets allow us to invest

more, we will be investing more and sticking to the 2.0 kind of leverage ratio. So we do not intend, at this point, to slow down our investment in order to bring our ratio to 1.0 below because we don't see any financial strategic point in that.

Anna Kurbatova:

Thank you very much.

Mikhail Shamolin:

Yeah, and of course, the biggest part of our official investment is Segezha West, and this is still a project under consideration. With our existing portfolio projects, we will be well below 2.0 at this point, and we have to think more about development opportunities and M&A because basically we are a company with the EBITDA of about half-a-billion dollars right now. And if we compare ourselves with the kind of leaders of the industry globally, the largest companies have EBITDA of around three billion US dollars, and the kind of the next role of midsized players have an annual EBITDA of about 1.5 to 1.7 billion and this is where we want to be.

Well, if you want to make Segezha kind of in this group of global midsized companies, it's too difficult to shoot for three billion at this point. Maybe we'll get there a few years down the road, but right now, our kind of interim goal is to end up in the 1.5, 1.7 billion annual EBITDA kind of figure and that's where our investment program is kind of taking us toward.

Anna Kurbatova:

Then can I make just a very short followup. Segezha West will definitely contribute to this plan to 1.5 to 1.7 range because you indicated that you expect generating from Segezha West 45 to 50 billion rubles in annual EBITDA, right?

Mikhail Shamolin:

Absolutely correct, yes.

Anna Kurbatova:

So Segezha will move you up on the global scale in three years' perspective?

Mikhail Shamolin:

Absolutely.

Anna Kurbatova:

Okay. Thank you very much.

Mikhail Shamolin:

You're welcome.

Operator:

Thank you very much. Our next question comes from Mr. Mikael Doepel, from UBS. Please go ahead, sir.

Mikael Doepel:

Thank you. Good morning, or perhaps good afternoon everybody. Just a couple of questions here from my part. Firstly coming back to the Segezha West project I have few questions, one is on the cash cost of that production. Is that something that you have outlined already or done the analysis? I mean, you gave OIBDA target there, but I guess it's another assumption of cash cost in terms of SW. That would be my first question.

Mikael Doepel:

And the other one would be on the... I think you mentioned that you plan to close down the old pulp mill once Segezha West starts up, if the project goes ahead of course. What is the capacity of that project? Let's start there.

Mikhail Shamolin:

Okay. On the first one, we indeed have done a very detailed financial model of Segezha West, and we understand both the cost side and the revenue side very well. We have calculated logistics, raw material logistics, all the kind of investments we need to do in the infrastructure expansion; railroads, roads, new machinery, trucks, et cetera, et cetera, et cetera. So we understand the production cost very well. We understand the revenue side and the markets very well, too. And besides solving a number of engineering questions, and approving the project with the local and federal government, we don't really see kind of what much else can go wrong with this project.

And the second question, the connection is not great, so I'm not sure I heard it correctly. The three paper machines that we have right now, we'll be adding another paper machine with 230,000 tons to utilize the new pulp which will be produced by Segezha West.

Mikael Doepel:

Okay. And just to clarify, the capacity of the old pulp mill is how much as of today? And then secondly, did you say that you plan to also build a 230,000 ton sack paper machine slot or did I misunderstand that?

Mikhail Shamolin:

Yeah. The capacity of existing mill, in terms of pulp production, it translates to about 370 to 380,000 tons of paper. The capacity of paper machines is about 410,000 tons per year. So there is a bit of a disbalance between how much pulp we can make versus how much paper we can make. And we typically seal this void by purchasing a market pulp from the market like this year, we purchased bleached pulp and we actually produced white paper on our paper machines, right?

So with the improvements that we make in Segezha pulp and paper mill now, next year, we'll be able to increase our pulp production to match our paper machine capacity, right? So we're going to be producing over 400,000 tons of pulp and paper next year in Segezha Pulp and Paper Mill. And potentially with further advancements, we can increase the production in existing pulp and paper mill to about 500,000 tons after the rebuild of the paper machine number nine which is actually planned for 2022, right? That's one of our investment projects.

Now, the new mill, Segezha West, will have a capacity of 1.5 million tons of pulp; out of which, 500,000 tons of pulp will be transferred to the existing paper machines and that is unbleached pulp, right? As we make half-a-million tons of unbleached kraft paper and together with Segezha West, we are planning to build one more pulp and paper machine for 230,000 tons which will produce 230,000 tons of bleached white kraft paper, right? So all together, it will be about 750,000 tons out of 1.5 million which will be processed into paper on the existing mill plus the new machine, right? So into the open market, we only

plan to sell about 750,000 tons of pulp which given the size of the global market, is not a big volume that can impact the price or demand in any significant way and that's why I say that there is very low risk.

And as far as the new 230,000 tons of white kraft paper, we also are quite confident, given that we've been in the paper market for quite some time and we know it pretty well, it is not a problem to sell that volume and most of it will be used in our own conversion facilities anyway because paper sacks that we sell, they consist of both brown paper and white paper. And up until today, we're producing the brown paper, but buying white paper from the market at actually quite expensive prices.

Mikael Doepel:

Very helpful. Thank you very much for that.

Mikhail Shamolin:

If that answers your question, yeah.

Mikael Doepel:

Yeah, no. Absolutely, it does. That's very helpful. Can I then just jump to the sawn timber, and the positions you have made there. You [inaudible 01:07:05] the M&A outpost [inaudible 01:07:08]. What do you think [inaudible 01:07:09] would be that number, and how should we think about that in terms of consolidating [inaudible 01:07:27] capacity numbers and do more?

Mikhail Shamolin:

It's a terrible connection. I'm not sure I understood anything that was said. Sorry, guys. Can anyone can repeat that for me? Rovshan, did you hear?

Rovshan Aliyev:

No. The same on our side. The connection is actually terrible.

Mikael Doepel:

Okay. Sorry about that. I was talking about the acquisitions that you have made in the first half. How are those [inaudible 01:07:54] with the revenue and earnings [inaudible 01:07:55] going forward? Did you hear that?

Rovshan Aliyev:

Okay. Understood now. Yeah, understood now.

Mikhail Shamolin:

Rovshan, go ahead.

Rovshan Aliyev:

Yeah. Just to make it clear to everybody, the question was how's the acquisition that we made in H1, currently working on finalizing, will include in our revenue? So our plan is we're going to start consolidating from September. So we will see some result in Q4 of this year. And then we will see the full impact of 300 to 350,000 cubic meters of the sawn timber in 2022, and then 400 to 450,000 which is 90% of capacity in 2023. So from Q4 of this year, about 50,000 effect, a full blast effect in the next year,

and the next year, we still will be working on some efficiency increase and then close to 100% acquisition in 2023.

Rovshan Aliyev:

At the same time, what we're going to see, we're going to see an immediate effect on the synergy under the forestry resource base that's very complementary to our existing plant in Lesosibirsky. So we're going to see some decrease of the cost of raw wood, and the logistics, and the synergy in that, and that's going to be a direct effect right away.

Mikael Doepel:

Okay. That's very clear. And just a final question on my side. In terms of the growth project or the growth CAPEX you are doing right now, are you able to quantify the benefit you expect to get from those, for example, an OIBDA level in 2021 and/or 2022?

Mikhail Shamolin:

To quantify what exactly once again?

Rovshan Aliyev:

The impact of the new project.

Vladimir Vinogradov:

The growth project, yeah.

Mikael Doepel:

Of the growth project, exactly, yes. That was the question, yeah.

Mikhail Shamolin:

Yeah. I mean, we obviously can't really give the forward-looking statements, but let me assure you, each project that we do has a very detailed financial model is well calculated. And I would say vast majority of our investment project have internal IRR numbers of around 30% in [inaudible 01:10:22] currency; so 30% RR, pretty much all of them. Some of them have 25, but not a single project have an RR below 25%. And of course, the numbers can change depending on the price cycle and sort of what's happening globally.

But again, strategically, we don't see any major global risks to the wood processing, and pulp and paper industry because of the growing demand for wood products in the world. Generally, more wood is used in construction, more paper is used as the plastic substitution. And pretty much everything we produce is in high demand and will remain being in high demand, especially with the fact that we are a green company, we are regrowing forest, and all the other side benefits that we have.

Mikael Doepel:

Okay. That's clear. Thank you very much. That's all my questions, and apologies for the bad connection.

Operator:

Thank you very much. Our next question comes from Mr. Artem Yamschikov, from Renaissance Capital. Please go ahead. Your line is open.

Artem Yamschikov:

Yeah. Hello, everyone. Thank you for the presentation and congratulations on results. I have two questions.

Firstly, on your sack paper and paper packaging prices and contracts, you mentioned that 60% that... and you believe that 60% of your contracts are long term. So could you please give us some indication what percentage of this long-term contracts have been already repriced at current spot market highs, and what percentage will be repriced in the said quarter and in the fourth quarter? So we want to understand if prices stay at current robust levels, to how long this repricing effect in your long-term contracts could last for your second packaging segment for the sack paper and packaging segment.

And second question, regarding your refinancing plans of your old debt which is more expensive. Could you please indicate your plans for the second half of the year, and what could be the impact on the average interest rate for your debt portfolio, and should we see lower interest payments in the second half of the year and onwards? Thank you.

Mikhail Shamolin:

Okay. I will comment on contracts and prices, and Rovshan will answer the question on debt restructuring.

The contracts actually work in a very simple way. We have about 60% for all the paper that we produce, sold in the open market, international market that is. And about 40% of paper that we produce, we convert into paper sacks.

Now, paper sack contracts are typically one-year long, and there is a price adjustment mechanism installed pretty much in each of those contracts and that is a tie to the paper index, the European paper index. So basically, this index changes. Then the price and the contract also change according to this index. So the prices on paper sacks, they grow or they go down into much lower pace than the prices of paper.

The paper is pretty much sold at the current market prices as oil. So we can have a contract with the trader or dealer like one year in duration, but the price can change every quarter in this contract depending on what's happening with the market. And so we very quickly rise and change our prices when the market goes up. And on the other hand, when the market goes down, the deal is in the customers [inaudible 01:15:03] the prices also very quickly. So it's a very fluid kind of situation. And regardless of how long the contract is, we will not be able to hold onto the price if the market goes down. It's just kind of the fact of life.

So in paper sacks, it's kind of much less impact and much more reaction to price change. On the paper side, it's a very quick reaction on the price change. And for that, Rovshan, will take up the question.

Rovshan Aliyev:

Yes. So on that, we are indeed... and that is a continuous process. We're looking at various mechanism of bringing the debt and restructuring to make it more attractive for the group. At this point of time, we are in the process of receiving the international credit rating and preparing ourselves for the international credit rating to have an opportunity to issue issue bonds.

And at the same time, some of the debt that we have already restructured at the beginning of the year and plan to restructure by the end of the year with an aim to reduce, in general, the cost of the debt by

around 100 BPC. So that is internal target that we'll have for the total group level. So yes, indeed, you should expect that the cost of the debt and the interest payment should be decreasing.

Artem Yamschikov:

That's clear. Thank you.

Operator:

Thank you very much. Our final question for today is a followup question from Mr. Igor Goncharov, from Gazprombank. Please go ahead.

Igor Goncharov:

Yes, thank you very much for the opportunity to ask followup question. Sorry to dig in again into the Segezha West topic, but I just wanted to... it seems that the start of the project doesn't look so remote now. In relation to the project finance instruction that you envision, do you have an understanding of what kind of partners you may have in this project finance infrastructure? Do you envision purely financial institutions or could it be participants with industrial background? Thank you.

Mikhail Shamolin:

Yeah. We have been in negotiation for almost a year with top three Russian commercial banks, the largest ones. And we do have sort of an understanding and a soft commitment from them, the finance that will be provided. Also VEB Bank is going to be participating in this project as we kind of... as the project development institution.

We signed a number of contracts with the government that will provide us with the tax breaks and the infrastructure support for the project. So we have been investigating the financing side for quite some time now, and we're fairly confident that financing will be arranged, but at reasonable rates and conditions.

Igor Goncharov:

Basically, we're looking at financial institutions or banks as the dominant partner in this project?

Mikhail Shamolin:

Yes. Yes, absolutely. It's banks.

Igor Goncharov:

Okay. Thank you very much.

Mikhail Shamolin:

You're welcome.

Operator:

Okay. Thank you very much-

Elena Romanova:

And we have another question from-

Operator:

Yes, please go ahead, ma'am.

Elena Romanova:

Sorry. We have another question from VTB. So the question is, "Could you provide us some details on your M&A plan? What products and geographic markets are you looking at? About a month ago, Mr. Shamolin had mentioned some plans in Egypt or expansion in Egypt. So what are the plans for M&A?"

Mikhail Shamolin:

Okay. Well, in Russia, we are mostly looking at M&A to enlarge our annual allowable cut. So basically, we're looking at M&A targets that have a large size long-term leases. We're not looking to buy mills or production facilities that much because there aren't many production facilities in Russia that we could buy, and the old ones that need reconstruction, and rebuild, and they're not efficient, are basically of not big interest to us. But annual allowable cut is basically a target, and we're looking at a number of potential M&A deals in that area which, of course, I cannot disclose, but we're working on them.

As far as international expansion is concerned, yes, there are few sites that we're looking at to expand our paper sack production, and Egypt is one of them. But, of course, M&A deal is only good as long as we can buy something at a reasonable price. And in Egypt, that's exactly the discussion we're having right now. So if we are able to agree on the price, then the deal will go ahead. If not, then we'll not. The deal is not critical or crucial to our strategy.

Elena Romanova:

And another question is on ESG, "CO2 regulations, is that to provide any incremental threshold for Segezha? What are your projections from the timeline of including forestry sector into European carbon regulation? And what steps are you making to support or accelerate the process of including if any?"

Mikhail Shamolin:

Well, it's all kind of fluid and in motion right now. We don't know exactly what the regulation will look like on both the European and the Russian side, but we're certainly preparing ourselves with the, first of all, reducing emissions in all of our plants, starting with the Segezha Pulp and Paper Mill. And therefore, it's undergoing the program of modernization right now, 2021, and will be concluded in 2022.

And also, responsible forestry management. We're investing in forest planting facilities. We're building one in Kostroma region and we will launch it next spring. The first kind of plantation-type forestry management. So we'll see.

One other aspect that we're looking at is acquiring agricultural land and growing forest on agricultural land. And then there has been a decree by the Russian government that allows companies to do that, so that maybe also a beneficial strategy because by growing new forest, we will actually be earning carbon credits and potentially, we'll be able to trade them. It's very difficult to estimate what kind of EBITDA numbers we can get from that, but we're quite sure that we we'll be able to get something. And the timing of all this happening, we believe is going to be around 2024.

Operator:

Thank you. I'm seeing no further questions. I'll pass the line back to the team for their concluding remarks.

Elena Romanova:

Well, thank you everybody for joining us for our first call as a public company. We're really grateful, and see you soon on the next call.

Mikhail Shamolin:

Yes. Thank you, everybody. And any further questions, you can address directly to Elena, or Rovshan, or myself. We are always available at your disposal.

Vladimir Vinogradov:

Thank you very much.

Mikhail Shamolin:

Thank you.

Rovshan Aliyev:

Thank you, guys.

Mikhail Shamolin:

Bye-bye.

Rovshan Aliyev:

Bye.

Operator:

Thank you very much. I'll be now ending the call and closing all lines.