Business Review – Finance Director's Review

FINANCE DIRECTOR'S REVIEW


Marek Jelínek, Executive Director and Chief Financial Officer

Adjusted earning per A share of EUR 0.86

Significant reduction in net debt, down by 34 per cent to EUR 321 million

Strong cashflow from operating activities of EUR 315 million

Return to dividend payments

Successful placing of EUR 500 million senior secured notes

EBITDA

€464m

We re-instated dividend payments this year. We paid an interim dividend of EUR 0.21 per A share, and declared a final dividend of EUR 0.22 per A share taking the total dividend for 2010 to EUR 0.43 per A share in line with our dividend policy.

Strong cash position

€529m

Overview
We delivered a strong financial performance in 2010 but perhaps our key achievement was to reach our stretch coal production target of 11.4Mt while keeping unit costs under control.

Our revenues rose significantly to EUR 1,590 million, up 42 per cent compared with 2009 (2009: EUR 1,117 million), helped by the increase in sales volumes and a strong recovery in commodity prices, especially for coking coal and coke, as we saw prices increasing quarter on quarter throughout the year.

EBITDA from continuing operations also increased significantly by 160 per cent to EUR 464 million (2009: EUR 179 million) driven by a combination of three factors: the increase in sales volumes, rising prices and stringent cost control.

Total EBITDA increased to EUR 468 million in 2010 (2009: EUR 186 million) including EUR 4 million from discontinued operations.

Adjusted earnings per A share were EUR 0.86, compared with EUR (0.25) for the same period in the previous year.

Revenues
Our largest source of revenue is from sales of coking coal, which accounted for 68 per cent of total revenues in 2010 with rising prices driving up revenues by 65 per cent to EUR 739 million (2009: EUR 449 million). Average sales prices for coking coal reached EUR 141 per tonne in 2010, up 62 per cent on the EUR 87 realised in 2009.

By contrast, revenues for thermal coal fell slightly to EUR 343 million (2009: EUR 351 million), reflecting a 13 per cent decline in average sale prices for thermal coal to EUR 63 (2009: EUR 72 per tonne).

We saw a dramatic increase in coke revenues, up 188 per cent to EUR 303 million (2009: EUR 105 million), largely driven by increased sales volumes and an 84 per cent increase in prices to EUR 275 per tonne compared with EUR 149 per tonne last year, as demand recovered.

Operating expenses
Our total operating expenses including depreciation and amortisaton rose by 12 per cent to EUR 1,271 million (2009: EUR 1,137 million) reflecting increases in external coal consumption for coking coal and due to higher levels of coke production, increased consumption of mining materials and higher personnel and contractor expenses as a result of increased production and development works. Total operating expenses also include transportation costs, which are re-invoiced to customers and thus have no impact on our bottom line.

Costs for energy consumed in coal mining declined by 14 per cent as a result of a 22 per cent fall in electricity prices, partially offset by an increase in electricity consumption of 4 per cent. Increased production drove up the number of shifts by 20 per cent and led to an increase in the number of contractors employed, resulting in a 30 per cent increase in contractors costs.

Although an agreement with the unions held our basic wages at the same level as in 2009, we delivered on our promise to share the success of our strong performance and paid a well-deserved summer and winter bonus to our mining employees. As a result, total personnel expenses increased by 2 per cent on a constant currency basis.

Mining unit cash cost rose by 4 per cent on a constant currency basis to EUR 71 per tonne as we intensified our development efforts at the end of 2009 and into 2010 with a view to returning to higher operational capacity. Previously postponed repairs to longwall equipment were completed, driving up maintenance costs and the inevitable additional costs of mining deeper in more demanding geological conditions added to the increased usage of mining material and equipment for the new longwalls.

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Net operating cash flow

€315m

Unit cash costs for coke showed a very positive trend, declining 20 per cent on a constant currency basis, from EUR 84 per tonne in 2009 to EUR 70 per tonne in 2010. This decrease was mainly driven by the significant increase in production, up 19 per cent to 1.0Mt. We expect this trend to continue into 2011 as we reap the benefits of consolidating our coke production onto a single site.

Capital expenditure ('CAPEX')

Total CAPEX in 2010 was 12 per cent below 2009 levels primarily as a result of the completion of the POP 2010 investment programme in 2009.

Our CAPEX for the year was EUR 221 million, including the final investment in the Productivity Optimisation Programme 2010 ('POP 2010') where we had negotiated deferred payment terms to help conserve cash in 2009. Significant productivity improvements from POP 2010 have fully vindicated our decision to continue investing during the downturn and we are now reaping the benefits of that investment.

The Coking Plant Optimisation Programme 2010 ('COP 2010') project was completed by the end of 2010. The concentration and modernisation of the coke works makes us a more cost efficient, environment friendly operation and gives us more flexibility to adapt to market demand by making it easier to switch between the production of blast furnace coke and foundry coke, adapting to market demand. There will be some on-going costs to decommission the Jan Šverma site and we are currently looking at the most efficient ways of completing this process.

Exchange rates

The Czech Koruna/Euro exchange rate is the foreign exchange rate relevant for us, as our revenues and expenses are a mix of both currencies. The Czech Koruna has been volatile during 2010, strengthening towards the end of the year leading to an average exchange rate of CZK/EUR 25.28 and appreciating by 4 per cent during the year. We partially mitigate the effects of the currency fluctuation with our hedging policy, as we aim to cover approximately 70 per cent of our cash flow exposure with currency forwards. Whilst this policy will not change going forward, we will be changing the way we implement this to reflect the increasing move to quarterly pricing of our products.

Cash flow

Cash flow in the period was strong, influenced by the positive dynamics of commodity pricing, increased revenues from coal and coke and a corporation tax rebate.

The net proceeds from the sale of NWR Energy a.s. to Dalkia Ceska republika a.s., which amounted to EUR 125 million, led to a further positive effect on net debt.

Net operating cash flow amounted to EUR 315 million in the year, up by EUR 139 million as compared with 2009. The significant reduction in our inventories also contributed to cash flow improvements (a EUR 30 million impact). At the same time, during 2010, there was a negative impact of EUR 66 million with respect to the increase in receivables. Our working capital is now back to normal levels.

Dividends

As our financial performance improved, we re-instated dividend payments this year. We paid an interim dividend of EUR 0.21 per A share, and declared a final dividend of EUR 0.22 per A share adding up to total dividend for 2010 of EUR 0.43 per A share. This is in line with our dividend policy, to distribute 50 per cent of the Mining Division's consolidated annual net income over the course of the business cycle, which remains unchanged going forward.

Liquidity and capital resources

During the year we significantly reduced our net debt by over a third to EUR 321 million, from EUR 486 million at the end of 2009. As of 31 December 2010, we held cash and cash equivalents of EUR 529 million.

We undertook a major balance sheet initiative in the spring of 2010, refinancing a package of senior secured bank facilities. We successfully placed EUR 500 million senior secured notes due in 2018 with 7.875 per cent coupon to repay the senior secured bank facilities supplemented by approximately EUR 181 million from cash resources.

We start 2011 in a strong financial position with a favourable environment in which to pursue our strategy.

This enabled us to defer our debt maturity, with our earliest bond maturity date in 2015. This timing is important as it gives us the necessary financing headroom in light of the high level of capital expenditure we expect over the next five years related to the development of Dębieńsko. We were also able to take advantage of a strong credit market in the spring to lock in favourable terms. We had withdrawn a bond earlier in the year as spreads widened following worsening conditions in peripheral European economies, only returning to the market when conditions had improved. This demonstrates our ability to remain flexible and disciplined and move opportunistically to take advantage of favourable market conditions.

We have also strengthened our financial position by securing a EUR 100 million Senior Secured Revolving Credit Facility ('RCF') in the first quarter of 2011. The RCF will be available for three years after the date of signing and the proceeds will be used for general corporate purposes. Although we do not envisage drawing down in the near future, we are always aware that we operate in an industry, which can be unpredictable at times, making it prudent to have additional resources at our disposal if required.

Outlook

We start 2011 in a strong financial position with a favourable environment in which to pursue our strategy. However, we will continue to experience the general mining sector inflationary pressures as well as rising costs related to the increasing depths at which we mine. We also expect the Czech Koruna to continue strengthening during 2011, which will translate into higher headline costs.

For 2011, we have revised our CAPEX requirements in light of incremental development with a view to maintaining production volumes and mix, as well as ongoing provision for replacement and renewal of longwalls in particular. Additionally, we are also provisioning for higher safety-related CAPEX, especially as the underground environment becomes increasingly challenging. We believe that going forward our CAPEX requirements will be between EUR 200–225 million per annum. On the assumption that the Dębieńsko project is signed off, a further EUR 50 million of CAPEX has been allocated for next steps in 2011.

Our plans for reincorporating in the United Kingdom during 2011 and thus becoming eligible for FTSE UK Series Index inclusion continue to progress. The reincorporation should give us increased exposure and further access to premium international capital markets.

We will also continue to pursue strategic opportunities in the region, underpinned by our financial strength and track record of successful operational performance and financial expertise.

Marek Jelínek
Executive Director and Chief Financial Officer

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SAFETY – AN ONGOING COMMITMENT TO ZERO HARM

NWR successfully completed its SAFETY 2010 programme at the end of 2010. SAFETY 2010 entails the largest purchase of mining work equipment ever realised in the Czech Republic. This two-year project was primarily focused on replacing personal work wear and technical equipment with the latest innovations. The new equipment has not only improved safety but also general working conditions underground.

As in other technological fields, advances in science allow equipment to become more compact and lighter. For example, the new underground mining lamps are now half the size and weight of their predecessors, which makes a noticeable difference to the miners on a daily basis. Thanks to the use of NiMh dry accumulators, the new lamps have enhanced safety.

Furthermore, as part of NWR's ongoing commitment to improving safety conditions, the Company has implemented stringent safety regulations, processes and monitoring systems at all its operations. Additionally, employees are encouraged to appreciate not only wider potential risks but also to have a greater sense of responsibility for their own safety and that of their colleagues. NWR runs several initiatives to promote a safer workplace, which are based on an improved dialogue between employees and senior staff in day-to-day operational life. These include 'suggestion boxes' for employees on ways to improve safety, working conditions and efficiency with the most viable ideas being rewarded.

As a result of the initiatives we have undertaken, the number of injuries at OKD, decreased by 22 per cent, from 346 injuries recorded in 2009 to 271 in 2010. Similarly, the LTIFR dropped from 12.00 to 9.13, exceeding the target set for 2010.