

## Gazprom Neft PJSC

### Financial and Operating Results in Q3 2018

16 November 2018

#### Anna Sidorkina, Head of Investor Relations

Good afternoon, ladies and gentlemen, I am pleased to welcome you to our regular conference call. Today we are presenting the Company's IFRS financial results for nine months of 2018. Alexey Yankevich, our CFO and member of the Management Board, will open the call by presenting our key business results and will also present the financial section, which you can find on our website as a webcast. Then Alexey Urusov will tell you about the upstream business, and Vladimir Konstantinov will tell you what happened in the third quarter in downstream.

As usual, before starting the presentation, I would like to remind you that all comments in the presentation, and all the statements made during today's conference call may and will contain forward-looking statements that relate to the financial position and business results of Gazprom Neft. All statements, other than assertions about past facts, are or may be treated as forward-looking statements. Such statements express expectations about the future based on the current situation and assumptions made by Company managers, and involve both known and unknown risks and uncertainties that may cause actual results to differ materially from those, which are contained in or implied by the conference call today.

Thanks for your attention. I will now hand over to Alexey Yankevich

#### Alexey Yankevich, Chief Financial Officer

Good evening, ladies and gentlemen.

Today we are presenting results for the nine months and the third quarter. The results are outstanding. Our key indicator – operating profit – grew by nearly one and a half times in nine months and net profit was almost 60% higher. You should remember that the industry faced quite tough limits on production in the first half of the year, under the OPEC agreement. But the limits were partially lifted in the third quarter and quotas were increased. Gazprom Neft made best use of the opportunity and rapidly increased production, resulting in a very good quarterly dynamics. Production growth was 5.6% and EBITDA increased by 15.9%, and only half of this improvement relates to price – the rest was due to production growth and efficiency gains. Net profit rose by almost 37%.

I will now hand over to representatives of our downstream and upstream divisions. Alexei Urusov, our chief economist, will talk about upstream and, as usual, Vladimir Konstantinov will comment on downstream.

#### Alexey Urusov, Head of the Economics and Corporate Planning Directorate

Good afternoon, colleagues.

We are continuing to develop our upstream resource base and we have several things to report in the last nine-month period. Firstly, we obtained new license blocks for geological exploration on the Yamal Peninsula. The South-Novoport and Surovy blocks continue our strategy of creating a production cluster in Yamal. Secondly, the State Commission for Reserves confirmed a reserve estimate of 416 million tons at the Neptun field, which was discovered by well drilling last year. That is much more than the initial estimate. Also exploration work that our company carried out in the last two years has discovered a gas and oil deposit at the West Messoyakhsky license block with initial geological reserves of 85 million tons. We are continuing work to create an oil production cluster in Orenburg, where we obtained licenses for subsoil use at the Pokhvistnevsky and Savitsky blocks, which have tight reserves.

Regarding production, you can see the growth trend in the third quarter, when the relaxation of Ministry of Energy requirements and limits enabled production growth at our mature fields, as reflected in the graph that you see on the left of the slide. Growth also continues in our two flagship projects, which are Novoport and Messoyakha. Operating expenses were down year-on-year by almost 5% due to cost savings at mature fields and economies of scale in large projects – unit costs go down as the scale of operations gets bigger. Our joint projects showed a slight increase of unit costs, due entirely to limitations on production



volume associated with restrictions imposed by the Ministry of Energy of one of our companies in the first half of the year. For international assets, there were some minor restrictions related to our foreign operations.

5 September, 2018, was a landmark date for us. On that day our company signed a deal with Mubadala Petroleum and the Russian Direct Investment Fund. A joint venture was set up at GPN-Vostok. The JV will now operate with three shareholders.

We continued work to advance and improve our oil production technologies. There were three important events I should mention. First, we carried out our first high-tech frack using a unique fluid with dynamic viscosity – the viscosity changes with pressure, giving an extra 7-10% increase of oil recovery from each well. Secondly, we have improved our technology for pressure control when drilling horizontal sections through Paleozoic sediments, so we can now drill sections of up to 800 meters. This means that we can go through difficult sections with varying degrees of fracturing, different permeability and solution absorption as the pressure changes. Increasing the length of the horizontal section offers major efficiency gains. We carried out a repeated fracking – a so-called refrack. We have changed the set of new-generation chemicals and polymers that we are using at the Archinskoye field. This technology will increase oil production at fields with carbonate deposits by up to 50%. This is an example of a technology challenge, which has been met and solved by Company specialists and scientists, and which we will be able to replicate to obtain a strong financial effect.

### **Vladimir Konstantinov, Head of Economics and Investment (Downstream)**

Good afternoon, ladies and gentlemen.

There were major fluctuations in the efficiency of crude oil supplies within the quarter due to oil price volatility. Increase of oil prices from USD 74 to USD 79 per barrel from July to September reduced refining margin from USD 5-9 to USD 1-5 per barrel and margin fell to zero in some periods at some European refineries. It stood at about USD 4 per barrel on average over the quarter. Total volume of crude oil in nine months of 2018 – the graph on the right – was comparable to the figure in 2017, but the allocation structure has changed. Refining volume increased by 2 million tons, mainly due to the Moscow Refinery, where the amount of repair work was lower than in 2017. The volume of crude oil supplied to the market, including the export market, was substantially lower. Continuing the refining theme, the next slide shows volume increases at various Company refineries.

The increase in refining by 1.2 million tons at the Moscow Refinery is due to the repair cycle, but the increase at Omsk, Yanos and NIS was due to economic factors – greater efficiency of refining compared with other uses of crude oil. The increase in refining volume was accompanied by an increase in refining depth and yield of light petroleum products. These are the fruits of management action to improve product structure and factors to do with repairs (that applies to the Moscow Refinery in particular).

The next slide shows how our refineries are continuing successful implementation of energy saving and environmental programs. The purpose of most of this work is to improve energy efficiency by optimizing the operating regime of furnaces, and by automating and updating electrical equipment and internal energy logistics. We estimate the total economic effect from energy-saving programs over three years at more than 1.2 billion rubles.

We commissioned the unique Biosphere biological treatment unit at the Moscow Refinery in 2017. The unit improves the quality of wastewater treatment. Construction work began on similar facilities at the Omsk Refinery, which will take 3 to 4 years to complete. The Omsk and Moscow refineries are piloting a new automated air monitoring system.

The next slide shows how sales of motor fuels have developed. Motor fuel sales increased by 3.3% in the first nine months of 2018. Average daily sales per filling station in Russia were 20.5 tons, which is the best indicator of any Russian filling station chain. The structure of motor fuels is improving, with growth in production volumes of the new-generation G-Drive 100 at the Omsk Refinery. Russian motorists rate our filling station chain as the best in the country: 40% of all respondents to the question, "Which filling station chain do you prefer?" named Gazprom Neft.

The next slide shows how premium sales of petroleum products other than motor fuels grew even faster in the first nine months of 2018. Overall growth was 9% and all major products made gains (largest increases were 12% for jet fuel and 30% for bitumen). Sales of environment-friendly low-sulfur marine fuel at Baltic ports increased by 14%.

To conclude I will say something about our use of new digital solutions in business management. I will give just two examples. The first is small-scale wholesale sales of petroleum products online, where we can ship the fuel within 24 hours after finalizing the sale at a fixed price. For comparison, the standard shipment time for fuel operators is several days. The second example is a set of digital solutions to ensure the safety and quality of motor fuel transportation by road. The solutions enable central online monitoring of up to 20 operating parameters on a fuel truck.

That's everything I had to say. Thank you.

#### **Alexey Yankevich, Chief Financial Officer**

Coming back to the financial indicators, as I already said – the trend is very good. Revenue for the nine months increased by 30%, and the quarter-on-quarter increase was 12%. I will say a bit more about operating profit in a moment. Net profit followed EBITDA. Growth in nine months was held back by negative exchange rate differences (they were positive in the first nine months of last year). But there was almost no negative impact from exchange rate differences in the third quarter.

The next two slides go into more detail on operating profit. If we compare nine months with last year, we can see that, apart from the price factor – which, of course, played a role – internal factors contributed about 60 billion. And this wasn't a volume increase – as I already said, we were living with the OPEC limitations. It was down to internal efficiency, both in refining and marketing (the result of successful completion of a major repair program last year and growth of premium sales) and in exploration and production, where we had structural improvements, with the successful development of new projects at the Novoport, Prirazlomnoye and Messoyakhskoye fields. Looking at quarterly dynamics, the role of internal factors in the overall structure is even stronger – it accounts for a half of the total increase and is particularly associated with E&P, where we not only improved structure but also grew volumes by moving quickly and efficiently to use the released quotas and boost our production. So the growth of financial results in upstream was driven both by growth at new fields and by growth at current assets thanks to use of the additional extra quotas. The growth in downstream came from increase of premium sales with high added value.

As for cash flows, the Company generated quite substantial free cash flow of 135 billion rubles in nine months. We also had what was quasi-free cash flow in the form of returns of previous investments that we made in Messoyakha, partly due to transfer of the field to project financing, partly due to the free cash flow at Messoyakha. Our divestments can also be added to free cash flow: these are the asset sales, which Alexey Urusov spoke about, including the Mubadala deal. We also decreased our loan portfolio (net borrowing was minus 75) and we paid dividends of 71 billion rubles. As a result, the total cash flow increase was 41 billion rubles.

Capital investments this year were mainly in refining, unlike previous periods, when the main driver was production and implementation of large-scale production projects. The situation changed to some extent this year. Refining took first place for investment growth. Really, this is something we have already talked about – it is something we had planned and predicted. Modernization of our refineries is now in its most intensive phase, and that explains the major investment growth in downstream. It was partially offset by lower costs in exploration and production, which we also predicted and talked to you about. The result was modest growth of capital investments by 5.8% year-on-year, and we expect to be close to the guidelines we already gave you for the whole year – either flat or a slight increase.

I will finish with a few words about financial stability, where the situation is more than just good. We are pleased with our financial stability and it would be fair to say that we are somewhat underleveraged. We have always said that we see our net debt/EBITDA in a range of 1-1.5 and that ratio currently stands below one, which gives us a lot of scope to implement any projects in the future. Things look good with the repayment schedule too – only 16% of repayments fall in the coming year and this amount is more than 100% covered by existing credit lines. We are absolutely sure that can meet these obligations in the coming year, and then we have a three-to-five year horizon.

I will end my presentation there. I would like to say once again that we are pleased with our results – they are good, despite the OPEC caps. We made the best of the situation, coming through the first half of the year successfully and taking advantage of the opportunities that arose in the third quarter.

Thank you for your attention. We are ready to answer questions.

## Q&A session

### Question № 1

#### Alexander Kornilov, ATON

Good evening and thank you very much for the opportunity to ask a question.

I actually have a couple of questions. Could you tell us your plans for capital investments in 2019 – do you expect them to grow or shrink, and can you comment on the breakdown between upstream and downstream? And the second question: you previously forecast growth of hydrocarbon production by 2-3.5% in 2019; could you comment on the drivers of this growth.

Thank you.

#### Alexey Yankevich, Chief Financial Officer

Alexander, thank you very much for the question.

Regarding the trend, we expect a fairly stable level of capex over the next two-to-three years. So we expect the level to remain the same at 370-380 billion rubles in 2019. These are total investments, and there may be pluses and minuses, but we forecast total investment cash flow at around that level.

In regards of structure, the structural shift between production and refining will continue: the share of investment in refining will increase further in 2019 compared with 2018.

As for the production forecast, I can say straight away that we will be able to achieve the growth that we promised (2-3% for the year). You already know the drivers – they are mainly large projects, which we have launched (Novoport, Prirazlomnoye, Messoyakha), as well as some new small greenfields that we have discovered and launched around our established assets. But we have to make the reservation that we still don't know for sure what will happen next year as regards the OPEC agreement – that is something that we have to treat as a factor of uncertainty. But we are prepared for the level of growth that we have stated, and we can achieve it.

#### Alexander Kornilov, ATON

Alexey, thank you very much. Can you just clarify one thing: is the capex figure that you give (370-380 billion) consolidated capex or does it include shares in affiliates?

Thanks.

#### Alexey Yankevich, Chief Financial Officer

It is the investment cash flow figure that you see in IFRS.

Thanks.

### Question №2

#### Alexander Burgansky, Renaissance Capital

Hello, thank you very much for the presentation and for the opportunity to ask a question.

At the end of this year, Tatneft is going to launch a gasoline production unit at TANEKO. As far as I understand, they currently buy gasoline, including from you. I would like to know if this will affect your gasoline sales next year in any way.

Thanks.

#### Vladimir Konstantinov, Head of Economics and Investment (Downstream)

Colleagues, occasional purchases and sales of gasoline between us and Tatneft do not significantly affect our sales in certain regions or our market share. So I don't think that commissioning of the unit you mention will significantly affect the market position of our company.

### Question №3

#### Olga Danilenko, Prosperity



Hello, thank you very much for the presentation, it was pleasing to hear your announcement of dividends for nine months, thank you very much for that.

Two questions. The first is about your statistics for oil production in September 2018, which show a serious drop in oil production at the Prirazlomnoye field. What is the reason for that and what can we expect in the future? Unfortunately, I don't yet have statistics for October.

The second question is about the level of export duties on crude oil in the third quarter of 2018. I see that you have a 4% quarter-on-quarter decline in rubles, even though the ruble weakened in the third quarter. But sales in tons are unchanged quarter-on-quarter, oil prices have also increased, and the standard level of export duty increased. Were there any specifics of an accounting nature that explain why export duties fell in this particular quarter, and will the effect be compensated in some way in coming quarters?

Thanks.

**Alexey Yankevich, Chief Financial Officer**

Yes, Olga, thanks for the questions. Alexey Urusov will answer the first question, because he is responsible for upstream

**Alexey Urusov, Head of the Economics and Corporate Planning Directorate**

As regards changes in the volume of production at Prirazlomnaya: we have an annual shutdown to ensure safety of the platform, and if you look at the MD&A, even quarter-on-quarter, you will see similar reductions in the same period by a large amount last year, which were also caused by the repairs we talked about a year ago.

**Alexey Yankevich, Chief Financial Officer**

Yes, Olga, and about the duties – there are no accounting specifics here, nothing was taken out. The only possible reason is growth in the share of the fields that are entitled to subsidies, which could lead to an average decrease in the per-unit rate of duties, but we will check this and send you a comment as to why it happened. We need to take a look. But there are no special reasons for this, except, perhaps, an increase in the share of subsidized oil production in total volumes.

**Olga Danilenko, Prosperity**

Thank you very much.

**Anna Sidorkina, Head of Investor Relations**

Colleagues, thank you for taking part in the conference call. I would like to thank our managers who have prepared the presentation and answered your questions. It is Friday, so we won't keep you for too long. Have a good weekend. If you have any other questions, please write to us or call. All the best!