



Gazprom Neft PJSC

Financial and Operating Results in Q2 2019

8 August 2019

Anna Sidorkina, Head of Investor Relations

Hello, ladies and gentlemen.

Welcome to our regular conference call, dedicated to results in the first half of 2019. Allow me to introduce the people who will be taking part in today's call. Alexey Yankevich, member of the management board and CFO, will comment on financial statements. Igor Shkirov, Head of the Planning, Performance and Data Management Department in our Upstream Division will report on upstream business. Then Nikita Anichkin, Head of Economics and Investment in the Downstream Division, will talk about events in logistics, refining and marketing in the first half of 2019. We will be joined by colleagues from specialized departments for the Q&A session.

Before we start our conference call I would like to remind you that the presentation you see on the webcast on our site, and comments made during the presentation, may contain and will contain forward-looking statements relating to the company's financial position and the results of its business activities. All statements, other than assertions about past facts, are or should 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 contained in or implied by the conference call today.

Thanks you for listening and I will now hand over to Alexey Yankevich.

Alexey Yankevich, Member of the Management Board and CFO

Good afternoon, ladies and gentlemen.

We are pleased to present Gazprom Neft's results in the first half of this year. Revenue grew by nearly 7%, we increased operating profit by almost 11%, and net profit was nearly 30% higher year-on-year, driven by rising production at our new flagship fields – Novoport and Messoyakha – and helped by a positive external environment. As regards volumes, consolidated hydrocarbon production increased by 5.6%, but refining volumes were down due to repairs at our Pancevo and Yaroslavl refineries.

The quarter-on-quarter trend was also positive: operating profit rose by 6%. The main factor in the second quarter compared with the first was increase of production, by 4.1%. I will hand you over now to my colleagues. The first speaker will be the Head of Economics in the Upstream Division, Igor Shkirov.

Igor Shkirov, Head of the Planning, Performance and Data Management Department, Upstream

Good afternoon, colleagues.

Production growth, by 1.4 million toe (tons of oil equivalent) compared to the second quarter of 2018, was driven mainly by Gazprom Neft subsidiaries. As Alexey pointed out, the growth was mainly thanks to rapid development of the Novoport field as well as extra output from geological interventions and commissioning of the TL4 gas compressor stations at the Orenburg field. Joint ventures also showed a quarter-on-quarter increase of production, by 0.2 million toe. This was the Messoyakha effect, as well as further intensive drilling work and the use of new technologies, which we will discuss in more detail later on.

Introduction of new technologies is contributing to production growth, For example, in Yamal we completed work on a unique logistics system for year-round shipment and transportation of crude oil from the Novoport field. The final stage of this project was the start of operations by the Company's second icebreaker and launch of the world's first Arctic logistics management system – the Kapitan system. The system gathers real-time information on the location and movement of ships, accumulation of oil in storage facilities, checks the potential for standard deliveries of hydrocarbons to the market, carries out comprehensive online analysis



of fleet operation efficiency, helps to reduce time needed for planning and coordinating oil loading operations and optimizes transportation costs.

At Messoyakha, we have completed construction of new, technologically advanced horizontal wells using fishbone technology with eight lateral boreholes and with one of the highest complexity indexes in the industry. The technology maximizes exploitation of various sections of the productive strata, it is specific to Messoyakha and significantly increases the oil recovery ratio. You can judge the efficiency gains when I tell you that it took less than 25 days to drill 7.3 kilometres in the well.

In Iraq, a third production well was commissioned at the Sarkala field. Estimates suggest that the well has greater production potential than was previously forecast – up to 12,000 barrels per day. Drilling was carried out in difficult conditions, with abnormally high pressure and temperature in the strata, by an international team of specialists from 20 countries. This is a joint project with Gazprom Neft Middle East, supported by the Gazprom Neft Scientific Research Centre.

Per unit lifting expenses rose by 3.7%, mainly at mature fields. This has two key causes: the first is inflation, and electricity price and indexation of transmission costs; the second is the low base, because we suspended operations at wells with high water cut in 2018 due to the OPEC caps. If we compare with 2017, we can see on the graph that we are at the same level as in 2017 and lifting costs in large projects have not increased.

We are working with partners to reduce risk and increase value as we step up development of unconventional reserves and enter a new prospecting zone. Partnership is not just about sharing the financial burden and reducing risk capital, it is also a matter of acquiring extra competences and involving technology partners in the work. The partners we want to work with include Shell, Repsol and Zarubezhneft. A joint venture is being set up with Shell to develop fields in Yamalo-Nenets – the Tazovsky, Severo-Samburgsky, Meretoyakhinsky and two Vostochno-Yubeleini blocks with reserves of more than 1 billion tons of oil. We are joining forces with Repsol and Shell to develop a large cluster – a new prospecting zone where there is greater risk, but also unique opportunities for developing the resource base. With Zarubezhneft, which has much experience in the development of carbonate reservoirs, we are starting development of the Salymsky-3 and Salymsky-5 areas, which are mainly focused on the Bazhenov horizon.

Let me give a brief overview of the key performance results at new assets. At Yamburg, we have begun drilling horizontal wells, and we will use multistage hydrofracturing to get an idea of production potential at the field. As discussed before, Yenisei is a new prospecting zone without access to infrastructure, and the first important development stage was to confirm logistics strategy in the region, which we have done. A location has been selected for the construction of berths and equipment storage. We will delivery equipment and materials by the end of the year and drilling of the first well will begin in 2020. Models have been updated at Severo-Samburgsky. A mobile complex for well construction at fields has been launched at oil-rim deposits project, and oil shipments have begun from the Pestsovoye field, where two horizontal wells have been completed. Pre-launch tests are underway on an oil treatment unit at the Chayandinskoye field. We will commission Gazprom infrastructure this year. High-tech wells with record-length horizontal boreholes have been drilled at the Tazovskoye field. By the end of the year we will complete construction and installation work on the first stage of the energy centre. The Zima project is at the geological exploration phase: we carried out 540 square kilometres of exploration work and successfully completed the winter program of well development. Project indicators are ahead of the plan, and potential of the region looks even better than we had expected. The production forecast for 2019 is 338,000 tons.

Nikita Anichkin, Head of Economics and Investment, Downstream

Good afternoon, ladies and gentlemen. Allow me to present an overview of work by the Downstream Division in the first half of 2019.

The Brent price increased in the first half of the year compared with the end of 2018. Crude oil prices were substantially higher. Refining efficiency at the company's main refineries in the second quarter of this year reached USD 4 per barrel. There were no major changes in total crude volumes, but the following changes occurred as regards allocation of crude in comparison with the same period last year: first, there was an increased volume of sales up to 5.4 million tons of Arctic oil (12% more than in the first half of 2018); also there was an increase in volumes of export crude oil sales by 7.6%.



Trends in refining indicators are mainly due to repair work at refineries. The work, which we carry out, lets us work into the future without interruption and that means that we can be confident of providing fuel to the market in periods of traditionally high seasonal demand.

There were several events of significance for the downstream business in the second quarter of 2019. Firstly, we completed construction of an automated fuel dispatching terminal at the Moscow Refinery, which will reduce loading time by 4 times without any loss of accuracy. Secondly, the Omsk Refinery completed modernization of the filtration system on the small catalytic cracking unit, using modern wet steam cleaning technology. The used water is filtered and fed back into the production process. The system operates in a closed cycle with no environmental impact. This is part of our environment program, which we are continuing to implement. Thirdly, the up-to-date Gladkoye terminal, with annual capacity of 1 million tons of petroleum products, was brought into operation. It is important that this is the only fuel terminal in the Russian Federation equipped with metering stations that offer automated monitoring of volume and parameters of petroleum products when receiving loads from rail tanks and shipping to motor vehicles. We expect that all the company's main terminals will be modernized to "smooth" regime by 2025, which will boost transshipment volume to the company's own networks by more than 20%.

The next slide shows how our marketing business is progressing. You should note the seventyfold increase in sales through the AZS.GO mobile app – that represents about 1.5 million litres per month. It is also important to mention our new filling station product: we are launching and operating modular automatic filling stations. They are several times cheaper to build than traditional stations and take much less time to install. A modular filling station can refuel up to 350 vehicles per day.

The next slide shows results in the premium business segment. You can see that there was a positive trend in all segments during the first half of the year. In the bunkering business, we reached an agreement to provide LNG bunkering for the Ust-Luga - Baltiysk railway ferry. We began production of a new line of lubricant bases for Gazprom Neft drilling fluids. In the bitumen business, we launched online sales of bitumen binders on the electronic platform of the St. Petersburg Commodities Exchange. As regards aircraft fuel, the number of airports we serve increased in the first half of the year and we started using a new type of refuelling vehicle.

Finally, a couple of words about what we are doing in the petrochemicals business. The Company has increased its stake in Polyom LLC from 25% to 50%. In the second quarter Sibgazpolymer, the joint venture between Gazprom Neft and SIBUR, signed an agreement to acquire 50% of Polyom LLC from Titan group of companies. This will increase use of refinery feedstocks to make products with high added value. Raising our stake in Polyom is a step towards implementation of the long-term strategy of Gazprom Neft.

Thanks for listening.

Alexey Yankevich, Member of the Management Board and CFO

Ladies and gentlemen, coming back to financials and financial indicators, I should point out specific features of the net profit trend, linked with various impact of exchange rate differences. Exchange rate difference had biggest impact through the six months as a whole. If you look at the quarter, the effect was different and that caused profit to stay roughly at the level of the previous quarter, because the exchange rate differences operated in different directions.

Next, let me say a little more about the change in operating profit. Impact from the external environment was positive in this half year. If we put together price and tax factors and changes in exchange rates, the overall positive effect was about 29 billion and, in addition to these 29 billion, about 11 billion were internal effects – growth of production at new fields. As for downstream, the effects and the efforts we made to raise efficiency of the product mix went a long way to compensating for negative impact from repair work. But there was a lot of work going on – two refineries were under repair – so the result was close to zero, with a slight minus. The negative impact was compensated, but not completely. The picture is slightly different quarter-on-quarter, where the effect of the external environment is less. Here we see a bigger role of internal factors, volume and efficiency, which were positive in both upstream and downstream. So, in upstream we have production growth and production growth in new projects, and in downstream we have optimization of the product mix and growth of sales through premium channels (about 12% quarter-on-quarter). Efficiency in procurement and trading operations, optimization of the product mix overcame the negative effect of repairs and the downstream result in comparable terms was 2 billion better than in the previous quarter. The result in upstream was also better overall – we see an increase of operating profit quarter-on-quarter.

We had good positive free cash flow of 125 billion, which meant that we could pay a substantial amount of dividends. We paid interim dividends of 104 billion rubles for nine months of 2018, and that is not the last dividend payment – we also expect to pay final dividends. Overall net cash flow was 29 billion rubles.

Investments in the first half of 2019 were 178 billion rubles, that is excluding acquisition and sale of assets. Investments grew by 9% overall, mainly reflecting the intensive stage of refinery modernization.

As usual I will say something about liquidity to conclude the presentation. Liquidity was substantially improved, financial stability has got better, our net debt and financial leverage decreased. Net debt to EBITDA at the end of the second quarter was 0.54, which gives us a lot of scope for further borrowings. We have a substantial margin in reserve, so we feel quite comfortable as regards financial stability. That is everything I had to say. Let me end by saying that all our projects are moving ahead according to plan and we expect to maintain the positive trend until the end of the year.

Thank you. We are ready to answer your questions.

Q&A session

Question №1

Ekaterina Smyk, BofAML

Good afternoon, thank you very much for the presentation, I have a few questions.

First about the damping factor in downstream. Talks were underway to lower the benchmark price for gas and diesel prices in the spring. Did these talks have a result? Has the benchmark price level been lowered? What is the status of the talks at present?

The second question is about oil production. It grew substantially by the summer. Do you plan to leave production at the current level until the end of the year or will we see a decline by the winter?

And a third question about numbers. Looking at excise tax in the second quarter, can you break it down into its components? The excise tax itself, the damping factor and negative excise tax on crude oil, on oil refining?

Thanks.

Alexey Yankevich, Member of the Management Board and CFO

Thanks for the questions.

The first question was about the damper. I can only say that the formula for calculating the damper was indeed adjusted from July 1, but we will send you more detailed information. In principle, it is more appropriate for state bodies to comment on taxes, their rates and values. I can say – confirm – that, indeed, the formulas and calculations have been adjusted. We are already working under the new formula.

The next question was about production. Generally, we expect a steady trend until the end of the year without major fluctuations, and we expect production for the year as a whole to be higher than last year.

The next question was about breakdown of the excise tax. We will also send you the breakdown. Certainly, the damping correction and the reverse excise tax on crude oil are in the excise line in accounts, reducing the amount of excise tax. So, in principle, you can even calculate it yourself by year-to-year comparison, but we will send you a more accurate calculation of how much there is of each component.

Also let me say here and now that, like last year, we will hold a separate tax meeting, we will do a presentation for you and tell you in detail about all the changes, formulas, all the innovations, so that we can give it enough time, because otherwise we'll go in deep here, and we'll spend all our time just on taxes. So thanks for your understanding, we'll send invitations to everyone, everyone who is interested to hear about taxes.

Thank you.

Question №2

Alexander Donskoy, VTB Capital

Good afternoon, thank you very much for the presentation. Excellent results, congratulations.

I have questions about work at new assets. Could you please tell me how many wells will be drilled in 2019 and in 2020 and how much oil you plan to produce separately at Yamburg, Severo-Samburgsky, Otorochki and Tazovsky in 2020.

Thank you very much.

Alexey Yankevich, Member of the Management Board and CFO

Thank you very much for the question.

I won't tell you the exact number of wells now, we will send that to you later. As regards production in new projects, I can tell you that production at Otorochki will already be quite substantial, about a million tons, and there will be about 700,000 at Tazovsky and Severo-Samburgsky. We will send information a bit later for Yamburg. Those are the numbers I can give you today.

Thank you.

Question №3

Anna Kotelnikova, Sberbank CIB

Good evening, colleagues. Thanks for the presentation.

I have one question. You received very good dividends from the Arcticgas JV in the first half of the year. Could you comment on what further dividends you expect from Arcticgas in the second half of the year and separately from Messoyakha this year?

Thank you very much.

Alexey Yankevich, Member of the Management Board and CFO

Thanks for the question.

We have probably already received the biggest share of total dividends for this year from Arcticgas. You can find this in our cash flow statement. And the largest part of dividends received from joint ventures are precisely dividends from Arcticgas. We expect to receive something in the second half of the year, but it will be a much smaller amount, I won't say for sure now, but there will be some dividends before the end of the year, but not such a substantial amount as you saw in the first half of the year.

As for Messoyakha, we have other tools for distributing cash there, given that Messoyakha is more of an operating enterprise, so there might not be dividends as such from Messoyakha. As you will understand – we, as shareholders, naturally receive free cash flow from Messoyakha.

Thank you.

Question №4

Alexander Donskoy, VTB Capital

Could I ask one more question.

What effect do you expect this year and next year at operating profit level from your participation in Polyom?

Thank you.

Alexey Yankevich, Member of the Management Board and CFO

Thanks for the question, but I unfortunately don't have the figures to hand. If I find them by the end of the conference I will answer the question, but if not, we will send you the figures by mail.

Thanks.



Anna Sidorkina, Head of Investor Relations

Ladies and gentlemen, thank you so much for taking part in our conference call, thanks to our management for their good preparation and assistance in preparing the presentation, and for their answers to questions.

Let me remind you once again that we have sent you preliminary information about the upcoming tax meeting. We will let you know the exact time and date of the meeting a bit later, and we will definitely come back to all the questions, which we did not answer today, and send all the information to you.

Thank you very much and all the best, have a good evening.