

PJSC Gazprom Neft

Financial and Operating Results in 2018

21 February 2019

Anna Sidorkina, Head of Investor Relations

Good afternoon, ladies and gentlemen. Anna Sidorkina, Investor Relations. We are pleased to welcome you to our conference call.

Today we are presenting the Company's IFRS financial results for 2018. Allow me to introduce the participants of our conference call. Alexey Yankevich, our CFO and member of the Management Board, will present and comment on the financial statements. Alexander Mikheev, Head of Economics and Investments at our Upstream Division will tell you about the work of the Division in 2018. Then Vladimir Konstantinov, Head of Economics and Investments at our Downstream Division, will tell you about events in the refining and sales business in 2018. We will be joined by our colleagues from relevant departments for the question and answer session at the end.

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 for your attention. I will now pass you over to Alexey Yankevich

Alexey Yankevich, Member of the Management Board and CFO

Good evening ladies and gentlemen.

Today we are presenting financial statements of Gazprom Neft for 2018. The results are certainly good. There is one small novelty in our presentation today: we will begin the presentation, not with financial results, but with progress in the sphere of health, safety and environment. This shows our focus. As I have said at our earlier meetings, our focus and emphasis is on protecting the environmental, on ecology and on industrial safety. You can find more about this in our ESG-reports, which we plan to substantially expand and modernize. In previous periods, we didn't always show ourselves to best effect, we didn't say enough about what we were already doing. I want to emphasize that this is really important for our company. It is a goal that has been set at the level of senior management. Environmental indicators are built into the overall incentive system for top management. We are making good progress in this sphere. Our industrial injury rate (the number of incidents at our industrial facilities) declined in 2018. We are also improving with respect to the environment: our level of utilization of associated gas is on the increase, and it will continue to grow in coming years.

Moving on now to our main results, there was major growth of both production and financial indicators in 2018. Our revenue grew by almost 30%, EBITDA reached a record psychological threshold of 800 billion rubles – 45% more than in the previous period – and net profit increased by almost 50%. Hydrocarbon production rose by 3.5% compared with 2017 and refining volume increased. The improvement of financial results was not just due to a favorable external environment, although, of course, that helped; it was also thanks to our internal efforts, to the fact that we are successfully developing our new upstream projects. Growth continues at the Novoport and Prirazlomnoye fields, and at the Messoyakha group of fields. All this ensures growth of our overall production and, accordingly, of our financial results. Downstream business remains efficient and profitable, despite the difficult conditions last year, we are finding reserves for further improvement of efficiency in downstream. In particular, our refining depth increased year-on-year, as did average fuel throughput per filling station, and premium sales also increased.



Important events in 2018 included an increase of our share in the Arcticgas project to 50% and the successful closure of the deal with Mubadala and the Russian Direct Investment Fund for joint development of fields in Western Siberia, setting up a joint venture for that purpose. You know about this deal. It shows that we are an attractive company for western partners, that they are willing to work with us, and the result has been a very successful transaction. We also discovered a second field on the shelf of the Sea of Okhotsk, the Triton field (you remember us talking before about discovery of the Neptune field). So we have made progress and we are continuing to move forward in the preparation of new classes, new categories of reserves. As well as Bazhenov reserves, which we have talked about a lot, we are also working hard to develop Achimov reserves, including creation of our own regional model of Achimov strata in Western Siberia. We are staking a lot on this reserve category, both for Gazprom Neft and for Gazprom group as a whole. Quantities of Achimov reserves are very significant, and we are looking at technologies that will make it possible to develop them profitably. Also our logistics scheme is near to completion – we are finalizing the last elements of the logistics arrangement for Arctic oil shipments. Most importantly, the Alexander Sannikov and Andrey Vilkitsky supply vessels joined our fleet in 2018.

Turning to downstream, the first thing I would say is that our modernization program is moving ahead successfully. We plan to launch our first major project at the Moscow Refinery this year. Also, our fuel oils have been acclaimed as among the best in Russia – we won an award for fuel oil quality, which shows the standards of our refining and distribution.

I will hand over to my colleagues now. We will start with Alexander from the Upstream Division.

Alexander Mikheev, Head of Economics and Investment Department (Upstream)

Colleagues, good afternoon.

I am bringing you the business results of our Upstream Division in 2018. I will start with development of the resource base. We made substantial progress in this direction in 2018. We acquired licenses, mainly in Yamal, Orenburg and Khanty-Mansi Autonomous District. A total of 20 licenses were obtained with production potential of more than 800 million tons of oil equivalent. We also entered regions in 2018 that are new for Gazprom Neft: Krasnoyarsk Territory (the Gydansky Peninsula) and the shelf of the Sea of Okhotsk, where we discovered two fields, as already reported. Those were the Neptune field, for which we obtained a license in 2018 (the field was discovered in 2017) and the Triton field, which we discovered in 2018.

An audit by the independent international company DeGolyer & MacNaughton showed that we had 1P proven hydrocarbon reserves of 1.6 billion tons of oil equivalent at the end of 2018, which is almost 3% more than in 2017. The expansion of the resource base was mainly thanks to technology improvements in production drilling and geological exploration, and the introduction of modernized non-seismic exploration methods. The biggest successes were in geological exploration at the Alexander Zhagrin field, assets of Messoyakhaneftegaz, Salym Petroleum Development and others. Increase of reserves at the Yamal cluster in 2018 was 47 million tons of oil equivalent, which was mostly achieved through development of the Novoportovskoye and Tazovskoye fields. We carried out production and exploration drilling work at Arcticgas, which gave an increase of reserves by 49 million tons of oil equivalent. Increase of reserves at Khantos was mainly thanks to the Priobskoye and Alexander Zhagrin fields.

As has already been said, hydrocarbon production by the Group totalled 92.9 million tons of oil equivalent, representing an increase of 3.5% compared to 2017. The growth came from increase of our ownership share in Arcticgas, as well as production at fields in Iraq. There was also growth of output in our key projects, which are Novoportovskoye, East-Messoyakhskoye and Prirazlomnoye fields.

A few words about per unit operating costs. The picture is quite positive. Per unit OPEX decreased by 2.3% to 1726 rubles per ton of oil equivalent. This was mainly due to the closure of low-margin wells at mature assets and increase of production at our key large-scale projects as part of proactive management of high-margin production in the context of OPEC+ transaction restrictions. But our Tomskneft VNK joint venture felt negative impact from those restrictions.

Next, a little more about factors of production and efficiency growth in our key projects. Novoport deserves to be highlighted. The main events at Novoport were the launch and start of work by two icebreaking supply vessels, the Andrey Vilkitsky and Alexander Sannikov, which will provide year-round transportation of Arctic oil. I would also note that the Novoport project was included in the list of pilot sites of Gazprom Neft Group which will try out the new excess-profit taxation system in 2019.

The key factor for growth of production volumes at Prirazlomnoye was the commissioning of new wells. We commissioned three wells there in 2018: one production and two injection. At Messoyakha we have drilled a total of 137 production wells and fully implemented the exploration drilling program. Pilot work was carried out to test new production technologies – polymer flooding and testing of sectional wells with flow control devices in sub-gas zones. A number of infrastructure facilities were also launched to support production.

The key focus for management in 2018 as regards upstream assets was to fill the funnel of opportunities with new promising projects. These are what you see on the next slide – our projects in the Nadym-Pur-Tazovsky region, the new project in Yamal (the Severo-Samburgskoye and Tazovskoye fields) and further intensive work on Gazprom's oil fringes. We completed 13 production wells at the Tazovskoye field. Production increased by almost three times compared to the previous year, thanks to the new wells. Productivity of new Achimov deposits at the Priobskoye, Severo-Samburgskoye, Yamburgskoye and Tazovskoye fields was also confirmed in the context of these projects.

We are continuing work to find innovative technology solutions. We are trying to unlock the potential of non-traditional resources. This refers particularly to Domanik, Bazhenov and Paleozoic sediments. There is great potential: more than 500 million tons of oil equivalent. The Bazhenov Technology Center was established as part of the national project to create an array of domestic technologies. As part of its strategy the Center is developing non-conventional hydrocarbon reserves in Domanik deposits and at the Yuzhsky complex, and this explains our purchase at auction last year of two license areas in Orenburg Region: Savitsky and Pokhvistnevsky. Potential recoverable reserves at the areas are about 200 million tons.

Moving on to our technology strategy, the next slide shows the positive growth trend of our technology project portfolio. It is important here to highlight three key areas of our work. The first is the integrated program entitled "Methods to increase oil recovery rates". The key task here is to increase production efficiency at fields in late stages of development. Chemical flooding is one of the ways of improving oil recovery. A project is underway for the development of surfactant-polymer flooding, which makes it possible to extract an extra 19% of geological reserves. The second direction for work is sidetracking that keeps the main borehole in operation (so-called TAML-4 technology). This is a way of reconstructing wells by the drilling of sidetracks using hydraulic fracturing in the lateral wellbore while the main borehole remains in operation. The technology covers the drainage zone with sidetracks, so that residual oil reserves in the main borehole can be brought into production, increasing well productivity and raising the extraction factor. The third direction is robust integration of electrical exploration and seismic exploration. The key objective here is greater accuracy of the geological strata model by more accurate estimation of the volume properties of reservoirs and their saturation, achieved by integrating seismic and electromagnetic studies when we compile geoelectric parameters of the environment.

Thanks for listening.

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

Good evening.

We said at our previous meeting that the first half of 2018 was quite tough for refining. This was due to specific macroeconomic conditions, which came together in growth of the Brent price. The price of oil for refineries was high, and refining efficiency was very low. The situation changed in the second half of 2018, and particularly in the fourth quarter. Efficiency of refining increased significantly, reaching USD 4-6 per barrel at the Company's main refineries. The result for the whole year was that efficiency of refining was at the average level for the last 2-3 years. As regards structure of the crude oil balance, the Company's total crude resources grew only slightly, by less than 1%, but allocation of the resource changed. The share of refining increased significantly, by 7%. This was largely due to a different repair schedule last year (the amount of repair work in 2018 was much less than in 2017).

On the next slide, we see that most of the increase in refining was due to an increase of volumes at the Moscow Refinery, by 12%. But I would emphasize there were increases of refining volumes at all other Company refineries as well. Increase in refining volumes and the absence of large-scale repairs compared with 2017 gave an improvement of technical efficiency indicators. Refining depth increased by 0.5%. That was due to the Moscow Refinery. Light product yield was 0.7% higher.

As Alexey Yankevich said, ecology and safety issues are at the heart of our Company's concerns, and we have provided information about relevant projects that were implemented in 2018. They included an environmental project for the construction of a purification unit for process condensate at the Omsk Refinery. There were several major construction and reconstruction projects with relevance for safety at the Omsk and



the Moscow Refineries. We carried out railway logistics projects at Omsk as well as installation of a platform for automatic loading of light petroleum products into motor vehicles. These projects reduced irretrievable losses and increased the petroleum product shipment capacity, impacting the overall efficiency of refining and product marketing.

We made good progress with sales in 2018. There was a positive trend in the retail business, with increase of throughput per filling station to 20.7 tons per day, which (as before) is the best figure of any Russian vertically integrated company. We kept up work to develop our distribution network: 11 filling stations were acquired, 4 were built, a modern tank farm was brought into operation, and 10 filling stations were rebuilt. Revenue from sales of non-fuel products is increasing rapidly: it grew by nearly 10% in 2018. Our marketing campaigns are going well and the quality of our fuels is improving. Our G-Drive 100 fuel received a gold award at the “100 Best Russian Goods” competition. Our new app, AZS.GO (“Filling station.GO”) was launched, which lets motorists pay for fuel without getting out of their vehicle.

The B2B segment is developing faster than in previous years. You can see on the next slide that sales of jet fuel and bitumen grew at two-digit rates, and there were high rates of growth (7% or more) for bunkering and lubricants. The sales increase reflects efficiency gains and expansion of our network. We increased the number of airports where we have presence, the geography of bunkering sales expanded, we increased the range of our lubricant sales markets, and we acquired a production and logistics terminal in the city of Salsk in Rostov Region.

The last thing I wanted to tell you about is our project for catalyst production in Omsk. The project took a big step forward in February 2018 when an investment contract was signed by Gazprom Neft, the Russian Ministry of Industry and Trade and the Omsk regional government. This confirmed again that the creation of catalyst production in Omsk is a national project led by the Ministry of Energy. Our company is guaranteeing the involvement of leading Russian scientific organizations in implementation of the project, and the government is guaranteeing the stability of conditions for the project, tax actions and administrative support.

That's everything for downstream results in 2018. Thanks.

Alexey Yankevich, Member of the Management Board and CFO

Ladies and gentlemen, I will round off the presentation with a closer look at financial indicators.

I won't stay long on this slide, which shows trends. The trends are quite clear from our reporting. It will probably be better if I go straight onto facts about the analysis, where we comment on the operating profit trend as it was affected by various factors. If you look at year-on-year, the growth of operating profit was largely due to improvement of external conditions. But you can also see significant inputs from our internal factors. Actions by management – growth of volumes, business scale and efficiency – brought more than 76 billion rubles.

The quarterly dynamics are an industry trend. We can expect to see profit falls at nearly all companies in the fourth quarter compared to the third quarter. This was due to a sharp decline in oil prices towards the end of the fourth quarter. When oil prices fall sharply there is a negative duty lag effect: duty is calculated with a delay, so we get duties that are calculated on the basis of a high price, which no longer applies. That means that the Company usually loses out when prices fall like that. That is the major external price factor in the analysis of quarterly dynamics. Internal factors were more or less neutral. We had a certain increase due to oil production at new fields, but there were seasonal factors at work too – we greatly increased production in the third quarter, and we had to compensate that in the fourth quarter. That was because we were living for the whole year under the OPEC+ restrictions, and we had to enter this year with the caps that had been set for 2019. So there was a certain correction and, in addition, there was a “scissors” effect: at the same time as production decreased, expenses increased for seasonal reasons. We often have abnormally low temperatures in winter, and this winter was no exception; the temperatures were really low, and, naturally, we spend more money on heating, on energy, in the winter season. This meant that our costs increased and volumes fell somewhat, but, again, this isn't just to do with the specifics of the fourth quarter, but also of the third, which was exceptionally good for us. Plus, also, we had to carry out a number of geological and technical measures and well interventions in preparation for a new deal with OPEC. Generally, I would view the fourth quarter an unusually low. We expect growth of financial results going forward. If you are looking for guidance in your forecasts, you probably shouldn't focus on the fourth quarter.

The next slide is our free cash flow. Here we have something to boast about. We had very good free cash flow in 2018, significantly higher than in the previous year. You can also see that we obtained additional funds. This reflects our deal with Mubadala and the return of loans, which we provided in previous years to

finance investments at Messoyakha. A part of that is borrowed money, because we took a project loan for Messoyakha, but some of it is free cash flow of the project. So if we had treated Messoyakha as a joint venture, we would have had more free cash flow. But even without that, the figures are very good, and it means that we can pay good dividends. This will be a pleasant surprise for our shareholders, and we can definitely say that dividends for 2018 will be substantially higher than for 2017.

The next slide on investments. Investments slightly increased, overall growth was about 5%. In general, this is what we predicted, I said before that investments would be plus or minus 5%. The growth reflects investments in refining, due to the intensive stage of refinery modernization. This factor will continue to act for about the next 2-3 years, which is how long we need to complete the modernization program. After that our refining capex in downstream will decrease substantially. We will only have maintenance capex, which will be substantially lower than it was before, because most of the installations will be new. So we will be at a lower level than we were at when we entered the modernization program. We also expect substantial growth of margins in our refining business.

Let me end the presentation with a slide on financial sustainability. It is something we always like show. It doesn't require much comment. You can see how much our financial stability has improved in terms of debt to EBITDA. In principle, we even looked underleveraged. We went below one by the end of 2018. As I have said before, we traditionally prefer a comfortable range between one and one and a half. One effect of this is that rating agencies are gradually raising our status. We received an upgrade from Standard & Poor's, which brought us back to investment grade. And in February we had another upgrade from Moody's, which put us one step higher, moving us to the middle of investment grade with a Baa2 rating. This makes us optimistic that the others will follow Moody's example and also raise our level to mid-investment grade.

I will stop there. To summarize: the year was successful for our Company. We are looking to the future with confidence, we are on schedule with implementation of all our major projects, and we hope that we will have much to please you in 2019.

Thanks for your attention. We are ready to answer questions.

Q&A session

Question №1

Ekaterina Smyk, Bank of America Merrill Lynch

Good evening. Thank you very much for the presentation. I have two questions.

The first is about upstream. You had a major fall in production at Noyabrskneftegaz in the fourth quarter and, if I understand right, the Otdalyennaya group of fields should already have been making a large contribution to production figures for these assets. Were there any other factors besides the OPEC+ agreement, which explained the drop in production at these assets? And what is the normalized level of production there, not counting the Otdalyennaya group of fields?

The second question is about downstream. Could you comment on the current situation on the petroleum product market? There have been a lot of changes since the start of the year: the increase in excises, raising of VAT, the introduction of a damping mechanism. And at the same time, the price of oil has stayed quite low, and gasoline cracking in Europe is also below zero. Can you comment on how this has affected your profitability in refining and how it has affected prices for gasoline in Russia?

Thank you.

Alexey Yankevich, Member of the Management Board and CFO

Thank you for the questions, Ekaterina. As regards production in the fourth quarter – we had to adjust production, both to get our total production volume within the OPEC+ agreement and in preparation for implementation of the new agreement. As I said, our brownfields are a compensatory mechanism. These are the assets, which we use for most of the regulation of our production in order to meet the OPEC restrictions. For this reason, it is hard for us to give you a forecast, because a lot will depend on what the agreement will look like in the second half of 2019. As things stand now, we only know the limitations for the first half of the year. But, in general, we still plan to increase production from the spring, and this is due to the seasonal factor of quota distribution. So it is right that the fourth quarter was quite low relative to the average level. The first

quarter is also likely to be quite low. But you can be absolutely sure that production will grow in the second and third quarters.

As for the Otdalyennaya group – it doesn't have a noticeable impact so far. You won't notice it yet. But we can send you a breakdown showing more detail. Please contact our Investor Relations, we will give you a breakdown with a forecast for the whole Noyabrsk region.

As for the second part of the question – yes, there have been a lot of tax changes since the beginning of 2019. I would say that, overall, we expect the effect of all the tax innovations that we have had in 2019 to be fairly close to neutral. As we said, there are pluses and minuses. I can also say that, despite the difficult situation with gasoline, which you described, our refining remains in strong positive territory overall. As for the gasoline problem – yes, there is a problem with how the damper works for gasoline. We are now working with government to address this problem. We have always been very supportive of the progressive idea of a floating excise, and that might be the solution. But one way or another, there is a dialogue. And we intend to bring this dialogue to a logical conclusion. We see that all parties understand the problem. We just need to find a constructive solution, a way out of the situation for gasoline, because the situation certainly is quite unique.

Thank you.

Ekaterina Smyk, Bank of America Merrill Lynch

Thank you very much. Can I just ask for clarification regarding gasoline. The margin on gasoline clearly increased for Russian refiners in the fourth quarter. And it is clear that the margin on gasoline is now lower than it was in the fourth quarter. But do I understand correctly that it is still better than what we saw last summer?

Thank you.

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

Yes, you are right. I said before that the situation for refining was not very good in the first half of 2018. It had straightened out by the end of the year and efficiency of gasoline sales is now higher than it was in the first half of 2018.

Ekaterina Smyk, Bank of America Merrill Lynch

Thank you very much for the answer.

Question № 2

Christian Schuetz, PIMCO

Thank you very much for the chance to take part in this call. I have one question. In October, you announced plans to buy back your bonds on the market. How many bonds were bought back in 2018? And what are your future plans for this in 2019? Thank you very much.

Alexey Yankevich, Member of the Management Board and CFO

Thank you very much for the question, but, there seems to have been a misinterpretation. I don't remember any such publication, and we did not announce plans or buy back any bonds. Perhaps this refers to settlement. We have one Eurobond issue that reached maturity, and we settled it. But we have not carried out any buy-backs and we don't plan any for the time being.

Christian Schuetz, PIMCO

Thanks!

Question № 3

Evgenia Dyshlyuk, Gazprombank

Thank you for the chance to ask a question. I have a few, if you will allow me.

Could you tell me your capital investment forecast for 2019?

Secondly, I would like to clarify whether you expect the Novoport field to come under the excess profit tax regime from 1 January 2019? Can we build our models on that basis?

And the third question is about the damper. Do I understand correctly that you have a positive damper for diesel, and a negative one for gasoline? And is the positive damper meant to cover the negative one? So that the overall effect on the company is zero? Or does it still go into negative territory? Thanks.

Alexey Yankevich, Member of the Management Board and CFO

Evgenia, thank you for your questions. I won't say anything new as regards capex. You remember that we mentioned a figure of about 380 billion, our investment cash flow for this year. We plan to keep to that.

As for the Novoport field – yes, indeed, from January 1, it switches to the excess profit tax regime. You can model that.

And for question number three: yes, the dampers were different, but the overall effect is positive.

Thanks.

Evgenia Dyshlyuk, Gazprombank

Could I ask one more question? It is about dividend payouts. Can we expect the dividend payout ratio to be increased in this quarter already? Like last year, when you raised it from 25% to 35% payout in the last quarter. Can we expect some increase, for example, up to 40%? Thanks.

Alexey Yankevich, Member of the Management Board and CFO

The bigger, the better. We expect substantial growth in terms of dividends per share. But not by three times yet. If we grew like that every year, I don't know what would happen. But look, seriously – we have already taken a major step by increasing dividend payments to 35%. I can also say that this is not a one-off increase, it is our commitment – we will now pay at least 35% in the future.

And another piece of good news. You noticed a number of one-off transactions in our financial statements that temporarily reduced our net profit in the fourth quarter. Since these operations are one-off, by way of monetary revaluation, we want to adjust for these operations when we calculate dividends. So the payout will be 35%, but of an adjusted value, so the percentage will most likely be more than 35%, but still not the numbers you mentioned.

So, first thing, it will be more than 35% and, second thing, there will be significant growth compared to the level of dividends per share which we established at the end of 2017. Thank you.

Evgenia Dyshlyuk, Gazprombank

Sorry for monopolizing the time, but this really is my final question. I wanted to clarify: are you planning to continue making these net profit adjustments for the calculation of dividends? So it is not just on this occasion, but it will be some kind of permanent policy?

Thanks.

Alexey Yankevich, Chief Financial Officer

So we are having a conference call for two, are we? Of course, this is not our standard policy. But, if you recall, in previous periods we had significant external influence from various one-off factors that were not part of our business. In particular, there was a time when we had major FOREX and we made adjustments. That is more like what we will do, but we will take our cue every time from the situation that obtains. Right now we are helped by good cash flow, which we have earned, and by our liquidity, our financial leverage. We take everything into account. If we can act in a way that favours investors, we will of course do so. But I can't make a promise and take on such a serious commitment, because, on some occasion, it will depend both on the nature of one-off operations and on the situation that we find ourselves in as a Company. But all things being equal, of course, we will try to do the best thing for investors in these cases.

Question № 4

Charles Hirsch, Equinox

Thank you very much. It is an excellent and remarkable fact that your gas production at the Novoport cluster increased by 3.5 times last year. My question is about that: how do you plan to monetize this large volume of produced gas, which looks like becoming the first gas production centre in your Company?



Alexey Yankevich, Member of the Management Board and CFO

Thank you for your question. The main gas utilization scheme at the Novoport field, for the time being, is re-injection into the reservoir to maintain pressure and increase oil recovery. Other options are also being considered. We are ready to discuss them with you in detail, but outside the scope of the conference call. We can give you detailed comments about our plans (there are various options). Thank you.

Charles Hirsch, Equinox

Thank you.

Anna Sidorkina, Head of Investor Relations

Ladies and gentlemen, thank you very much for taking part in the conference call and for your questions. If you have any further questions, we are always ready to help, please contact Investor Relations. And thanks again to our management for the excellent presentation and their answers to the questions. All the best, until the next meeting.