



“Gazprom Neft” PJSC

Financial and Operating Results in Q3 2019

18 November 2019

Anna Sidorkina, Head of Investor Relations

Good afternoon, ladies and gentlemen.

I am pleased to welcome you to our regular conference call, dedicated to the Company's business results in nine months of 2019. Allow me to introduce the people who will be presenting at the conference call today. Our Chief Financial Officer, Alexey Yankevich, will comment on financial statements. Igor Shkirov, Head of the Upstream Planning, Efficiency and Data Management Department, will tell us about work of the upstream division. Then Nikita Anichkin, Head of Economics and Investment Department (Downstream) will talk about events in the downstream division in nine months of 2019. We will be joined by our colleagues from the relevant departments for the Q&A session.

Before we start, I should remind you that all comments on the presentation and all statements that are made during the conference call may and will contain forward-looking statements regarding the financial situation and results of the business 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.

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

Alexey Yankevich, Member of the Management Board and CFO

Good afternoon, ladies and gentlemen.

Today we bring you the nine-month business results of “Gazprom Neft”. The external environment for oil companies this year was not as favourable as in 2018, when oil prices started from USD 70 per barrel and rose to a record level of USD 82-83 by September. The subsequent correction led to more modest oil prices in nine months of 2019, which affected the results of all companies, although the price decline was partially compensated by a change in the ruble exchange rate. We managed to achieve a positive year-on-year trend in our financial indicators, despite negative impact of the external environment on results.

Revenue grew by 2.4% and we increased operating profit by 0.2% to 616 billion rubles, while net profit grew by 7% year-on-year to 320 billion rubles. This was made possible by increased production at new, highly efficient fields and by measures to increase efficiency in practically all business segments. Decline of refining volumes is associated with repair works at our Pancevo and Yaroslavl refineries. But the trend was positive overall and it is important that we achieved growth of both operating and net profit.

Negative impact of the external environment intensified in the third quarter of 2019, leading to a slight decrease of operating profit (by 1% quarter-on-quarter). Growth of refining volumes was due to the completion of repairs at our refineries and seasonal factors. Summing up the results, I would point out that the company showed a positive overall trend in the context of a less favourable external environment. I will hand over to my colleagues now. The first to speak will be Igor Shkirov, the Head of Economics in the Upstream Division.

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

Colleagues, good afternoon.

Hydrocarbon production grew both quarter-on-quarter and year-on-year. The quarterly increase in production was greater than 1% and we produced 71.9 million tons of hydrocarbons in nine months of 2019, which is 4.4% more than in the same period last year. The increase in production was mainly due to our highly efficient assets: fields in Yamal, Messoyakha and Orenburg.



Per-unit operating expenses are up by 7.3% compared with the same period in 2018, reflecting the low baseline in 2018, but they stayed level with 2017 and operating costs have not increased for large projects.

As well as launching new projects, we are giving much attention to efficient projects for maintain the resource base and production levels at mature assets. I can give you two examples. The first is a project at the Otdalyennaya field group, launched in 2014. Peak production there is forecasted at 1.7 million tons of oil-equivalent (toe) and we are already very close to that – production in 2019 will be 1.5 million toe. The group includes six fields that give substantial support to production by our Noyabrskneftegaz subsidiary in the Yamal-Nenets Autonomous Okrug. The second project is Zima, consisting of fields discovered in 2017. Target production there in 2019 is 0.4 million toe, but we want to achieve a much larger production volume of 4.4 million toe by 2024. The project will enter commercial production in 2021. A project for treatment of early oil has already been launched and well construction has been completed.

We are pushing ahead fast with our technology projects, experimenting successfully with fracking and learning new skills. In particular, we replaced a boron mixture with a mixture using polymer, which increased the fissure lengths by 15% and boosted well production by 20%. The Novoportovskoye field continues to set new drilling records – 1000 metres of horizontal wellbore in almost three days. At the Vostochno-Messoyakhskoye field, a high-tech well with depth of 3.2 kilometres was put into operation on Achimov deposits, and gave a flow of 435 tons of oil per day.

We are making widespread use of autonomous Russian-made technologies, including KRAB deep-sea stations. The KRAB stations are used for seismic exploration in the Ayashsky licence block. Before now, Russian oil and gas companies mainly used foreign-built equipment for this type of work.

Just recently, “Gazprom Neft” launched Russia’s first integrated field development centre, consisting of three centre-modules. The project management centre is designed to optimize project support and supervision, and the construction control system. The drilling control centre supports well construction. And the production control centre monitors oil and gas movements and gives production process forecasts. It is actually a separate centre, based on digital fields. Each of the centres optimizes its own processes, and there is an extra efficiency gain from synergy between them. The centres are located in one place, enabling integrated support for efficient field development.

Nikita Anichkin, Head of Economics and Investment, Downstream

Good afternoon, ladies and gentlemen. I will give you an overview of work of the downstream block in nine months of 2019.

Brent oil prices fell in the third quarter compared with the end of the second quarter of 2019, so the cost of oil was lower. Refining efficiency at the company's main refineries in the third quarter of this year reached USD 4.7 per barrel, taking account of changes in macro parameters. As regards oil allocation, there was an increase of export sales to 14.5 million tons due to growth of production at the Novoportovskoye and Vostochno-Messoyakhskoye fields, which is 14% better than the result for nine months of 2018.

Overall decline of refining volumes year-on-year was due to scheduled repairs at the Pancevo and Yaroslavl refineries in the first half of 2019. Completion of the repairs gave growth of refining volumes in the third quarter compared with the second quarter by 10.6%. The work that has been carried out means that we can optimize timing of the next repairs, and that will make us better able to provide fuel to the market in the period of traditionally high seasonal demand. Installation of key equipment for the catalytic reforming unit at the Omsk Oil Refinery was also completed in the third quarter, which will boost output of high-octane gasoline components by 1.5 times.

Moving on to results in premium business segments, you can see a positive trend for nine months in each of them. In jet fuel sales, “Gazprom Neft” increased its presence at 282 airports. Growth in the bunkering business was driven by higher demand for marine fuel via small wholesale distribution channels in the Northwest and Black Sea regions. We also began deliveries of a new, environmentally friendly marine fuel with sulphur content below 0.5%, meeting MARPOL requirements. In the bitumen business, we increased volume and broadened the range of premium products thanks to the launch of new high-quality brands of road bitumen. In the lubricant segment, we launched a new, high-tech product for marine engines, Gazpromneft Ocean, which also meets MARPOL requirements.



Motor fuels also deserve a mention. We made significant progress in the segment during nine months of 2019. It is particularly important that "Gazprom Neft" retained industry leadership by daily sales volumes per filling station. Success of the "On Our Way!" loyalty program was another important factor – it marked its tenth anniversary this year.

Finally, a few words about our "Gazprom Neft" pilot project. The first solar-powered plant with capacity of 1 MW has been launched at the Omsk Refinery. The project underlines our Company's attention to alternative development directions, as well as our traditional focus on environmental and safety issues.

Thanks for listening.

Alexey Yankevich, Member of the Management Board and CFO

Ladies and gentlemen, let me resume with a more detailed analysis of financial indicators. The overall directions were largely determined by the external environment, but we did our best to smooth the negative trends. As regards the year-on-year trend, decline in oil prices was partially compensated by change in the ruble exchange rate. But if you look at the quarter-on-quarter period, a quite major decline of oil prices (by nearly 10%) was not compensated by change in the ruble exchange rate, because the average ruble exchange rate stayed almost unchanged quarter-on-quarter at about 64.5 rubles per dollar. So in the third quarter the negative effect of lower oil prices was too large to be fully compensated by internal factors. Nevertheless, you can see that, although EBITDA and net profit decreased, the decline was very small. Overall, we maintained the second-quarter level.

Factor analysis of adjusted EBITDA shows that we more than compensated for the external environment year-on-year, and even obtained modest growth due to production increases at our new and highly efficient fields and optimization in the downstream business: expanding the product range, our production program and sales via premium channels.

The efficiency gains from internal factors were even greater quarter-on-quarter. Calculating on a year basis, we achieved growth of +16, but the impact of external factors was too great. Notice that we only include prices and taxes in external factors. But there were also a number of objective internal factors, in particular, the stoppage of our Prirazlomnaya platform for preventative work. This was a scheduled event that caused some worsening of the trend between quarters, but it was compensated in later periods. The third quarter could have been better than the second if we did not have that schedule of preventative work.

The nine months were very good in terms of free cash flow. We can easily make a fairly substantial dividend payment this year, and free cash flow is even bigger than that amount. We also have proceeds from the sale of fixed assets, which gives us positive net cash flow, even taking account of some modest spending on acquisitions. By acquisitions we mainly mean licences, but also an increase of our stake in the petrochemicals business, which we wrote about in our financial statements and in MD&A. Looking ahead, we can say that this did not affect cash flows for 9 months, but we will see the effect for the full year. The resolution on dividend payments was made and the dividends were paid. We also paid interim dividends for six months of this year. Looking at the 2019 calendar year, the total payout to shareholders will be a record amount, which we have never come close to before – more than 200 billion rubles. More of the additional cash that we earned was distributed to shareholders than to investments, because growth of the investment program was not very great. There was growth, but nothing comparable to the growth of absolute dividends, which we will see in 2019 cash flow against that for 2018.

Looking next at the analysis of trends in our investments – our capital expenditures, – the overall growth of investments was 16%, which is what was expected. As we said before, we are moving into the most intensive stage of our refinery modernization program: construction and procurement work is underway, so our spending on refining and marketing is close to its maximum. But these costs will decrease gradually from 2022-2023.

Investments in production have also increased. Capital expenditures are growing at mature fields too, for which there are two reasons. The first is that in 2019 we are starting from the low 2018 baseline. I should remind you that in 2018 we had to react quite fast to the OPEC caps in every way we could, including significant reduction of our work at mature fields. And what we are doing now is not so much building up production, as restoring it relative to last year, wherever we have been able to do so. The second reason is a specific accounting factor. We do not divide investments in detail between mature and new fields, so our classic mature fields, particularly in Noyabrsk region and Orenburg, include some small new fields. As a

result, the growth of capital investments from 84 to 97 billion rubles is also due to increase of investments at fields that can properly be considered to be new, and not mature. Specifically, this concerns the Otdalyennaya field group, which we already talked about, and the Orenburg cluster, where we have growing assets in the first and second stages of development. This is what I wanted to say about new projects at mature fields.

The growth of capital investments in new projects is logical, because they are still developing. As well as Novoportovskoye (our flagship project) we have two other major new projects coming up – the Tazovskoye and North-Samburgskoye fields, where we are also stepping up work, and therefore increasing investments. So on the one hand, we are moving on to a more intensive investment stage at our refineries, and, on the other hand, we are continuing to develop new fields.

There was some reduction in investments after we finished the implementation phase at Novoport, but there are new fields to deal with now, so investments are growing a little again. That is the sort of trend we expect, but we are keeping to our plan up to year-end, with capital investments of plus-minus 400 billion rubles. That is the sum we are heading for, and there are a number of additional projects that we have taken on because demonstrated very good results – large cash flow, – but that was done without any detriment to our shareholders, who received the largest share of our extra cash flow.

I will finish this overview of our financial results with some analysis of financial sustainability. Sustainability is improving because our net debt-to-EBITDA is reaching historic lows. We are close to 0.5, which is a fairly low indicator of financial stability, and offers much scope for further borrowing, which we can use in the future to achieve a better balance between the interests of shareholders and the goals of our business development. We have a lot of ideas and development directions, where we can achieve long-term growth in the value of the Company.

Also our interest rate on ruble debt rate has declined to 7.79% per annum as market rates decline. This is a very good indicator. We were borrowing at 8% per annum at a time of high oil prices and now, when conditions on the oil market are much less good, we are achieving a very low cost of debt. That also says something about the situation in Russia as a whole. We have had a very successful transaction, which confirms that – we placed 25 billion rubles of five-year bonds. What makes the placement special is that the bonds have a call option, so we have hedged ourselves against any further decline in rates. On the one hand, if rates decrease, we will be able to redeem the bonds at par and place them at a lower rate. On the other hand, we have a very good rate of 6.85%, which is an absolute record for us: I don't remember us ever placing ruble instruments below 7%.

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

Q&A session

Question №1

Evgenia Dyshlyuk, Gazprombank

Good afternoon and thanks for opportunity to ask questions. I have several questions.

First question: what caused the quite large increase of fuel sales on the domestic market in the third quarter? Do I understand correctly that lower prices for crude oil and fuels on international markets made the domestic market more attractive?

Second question: according to the new dividend policy, which Gazprom is expected to announce, the Group will switch to a dividend payout ratio of 50% for three years. Will "Gazprom Neft" move to a 50% payout faster than its controlling shareholder, and (assuming you can tell us) when can we expect that to happen?

Third question: roughly what level of capital expenditures should we expect next year?

Thank you very much.

Alexey Yankevich, Member of the Management Board and CFO

Thanks for the questions.

The first question was about growth of fuel sales on the domestic market. My answer is: of course, our sales are always focused on the customer – the same as any commercial company, – but in this case it has less to do with the price environment and more with the development of our marketing business and promoting our products. Specifically, we have made a lot of progress with bitumen and oil, and we have launched new products. The growth in domestic sales is more a result of our work to develop the business than any switch from export to the domestic market in reaction to customer demand. I mean to say that growth of fuel sales on the domestic market reflects expansion of the product range and work with premium distribution channels.

The next question was about dividends. The first thing I would say is that we are already quite close to the 50% target. Our last 6-month dividends represented a payout ratio of 40%. So we don't have far to go.

Secondly, we can confirm our intention to reach 50%. As to how quickly it will happen – it can't happen more slowly than our main shareholder. It might happen more quickly, but that will depend on many factors: the price environment, our needs for development projects and the balance between development and long-term value creation, on the one hand, and a shorter-term return of funds to shareholders as dividends, on the other. We have always tried to maintain an efficient balance between the two and we will continue to do that in the future, but I won't tell you an exact date.

The third question was about capital investments. We expect a net investment cash flow of plus-minus 400. That is the figure we expect for the next two to three years. Perhaps a bit more in some years and less in others. This is net investment cash flow, because we may have some divestments. We will optimize our portfolio, but you can expect the overall investment to be roughly at that level.

Thank you.

Question №2

Alexander Burgansky, Renaissance Capital

Hello. Thanks very much for the presentation. I have four short questions about upstream.

First question: what production growth do you expect next year, assuming that the OPEC+ production restrictions remain in place?

The second and third questions: could you tell in more detail about production plans for next year and 2021 at the Prirazlomnoye and Novoportovskoye fields?

And the last question: more detail on Prirazlomnoye. Based on results of the last few quarters, including the third, I get the impression that total production at Prirazlomnoye is slightly lower than you expected a year or two years ago. Does that match your understanding of how production is shaping up at Prirazlomnoye, and has that been done on purpose, as part of steps to limit production, or are you optimizing production in some other way? Are there any other factors that affect the level of production at Prirazlomnoye?

Thank you very much.

Alexey Yankevich, Member of the Management Board and CFO

Thank you for asking.

Regarding the production trend: if the OPEC+ restrictions don't change at all, it is hard to imagine any major growth. We expect that total hydrocarbon production will increase slightly, by about 1%. That is a conservative scenario. But we do still expect some movement and change.

As for production volumes by fields, let us send it later - I can't give exact figures now.

The last question was about Prirazlomnoye. Prirazlomnoye remains a growth asset for us. We expect production growth in the future, but you understand yourself that it's difficult to prepare an exact plan for such complex assets and expect it to always work out as intended – things happen differently sometimes. We are on target overall. Our investment model calls for some optimization, across the whole portfolio and at each

asset. We analyze capital expenditures against production and try to optimize our work in order to obtain the highest return on capital in various exploration and production projects. So plans are always being adjusted. In general, though, the asset will grow and the model for Prirazlomnoye is confirmed. Yes, there are some divergences, but they are not critical.

Thank you.

Question №3

Angelina Glazova, J.P. Morgan

Colleagues, thank you very much for the presentation and the chance to ask questions. Some of my questions have already been asked, so I'll ask my remaining question.

Regarding Arctic projects: there has been a lot of news recently about the Arctic and we have seen that "Gazprom Neft" could take advantage of new special terms to make substantial investments in the Arctic shelf and perhaps carry out gas processing projects. Could you give us some details on this or tell us when they are likely to happen, and to what extent this could change or expand your strategy in the Arctic?

Thank you.

Alexey Yankevich, Member of the Management Board and CFO

Thank you very much for the question.

We are certainly interested in the Arctic. But as regards the projects you are talking about – not our main oil projects, like Novoport, and not the rims that we are developing under an agreement with Gazprom, – you should understand that these are not even projects, they are ideas at a very, very early studies stage.

It's quite right that the Arctic is a region with huge oil and gas reserves, but monetization of these reserves has always been a major problem due to the geography and conditions there, and that is which why they have not been developed. There are various technologies that enable monetization of the reserves, and we are looking at these technologies now. But, for us, this is the studies stage, after which we will be ready to frame investment ideas for ourselves and discuss them with you. But as long as these are studies and not an investment idea, I am not talking about them with the investor community. Certainly, it is interesting and it will give us the opportunity to implement large and rewarding projects. The amounts you have heard about in the public domain are estimates of the scale of the projects that could be implemented. And if all of the preparatory work and studies are successful, if we find the right technologies, we will be able to carry out quite large and rewarding projects. The amounts in question are substantial, but all this is a very preliminary and we are at the very beginning of assessments, so this will definitely not have impact on our investment plans in the next three to five years.

The question is a very complex one, so allow me to add something. What I have just said is more related to gas chemicals projects and projects related to new technologies and monetization of gas and oil. You also mentioned the shelf. We have licences and fields on the Arctic shelf, but they are currently at the early exploration stage. We are pursuing geological exploration, but you already know about those plans, and you are acquainted with all the numbers. Talking about what is closer in time – what we expect to happen three to five years into the future, – we are working hard to develop and build a cluster around the Novoport field. We will develop reserves around Novoport. The fields there are smaller, but they can still contribute and help to load our Arctic infrastructure, our Arctic terminal. We will be investing in this project and you will see that in our investment plans. These projects use more or less traditional, tried and tested technologies, and my first comments were related to completely new projects, using technologies that have not yet been applied in Russia. They could produce large volumes, but they are associated with a high degree of uncertainty.

Thank you.



Anna Sidorkina, Head of the Investor Relations Section

Ladies and gentlemen, thank you for taking part in our conference call. A big thank you also to our management for preparing a highly detailed presentation and giving full answers to all the questions.

If you have any other questions, we are ready to answer them. We will send all the numbers that we promised.

Thank you.