

JSC Gazprom Neft

Financial Results for Q1 2015 19 May 2015

Anna Sidorkina, Head of Investor Relations

Good afternoon, ladies and gentlemen and welcome to the conference call for presentation of our financial results in the first quarter of 2015. As usual, our CFO, Alexey Yankevich, will present and comment on our financial results, after which Mikhail Zhechkov, head of the Upstream Economics and Investments department will tell you about upstream operations during the reporting period, to be followed by Vladimir Konstantinov, Head of Downstream Economics and Investment department, who will present events in downstream during the first quarter of 2015. We will round off with a question and answer session, so that you can put any questions you may have to our speakers and their colleagues from relevant Company departments.

As usual you can view this presentation as a web cast on our Internet site. I should note that the presentation and all comments to it and any remarks made during the conference call may contain forward-looking statements relating to the financial position and business results of Gazprom Neft. All statements, other than assertions about past facts, 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 known and unknown risks and uncertainties that may cause actual results, performance or events to differ materially from those, which are contained in or implied by the conference call.

Thank you very much for your attention. Let me hand over to Alexey Yankevich.

Alexey Yankevich, CFO and Member of the Management Board

Good afternoon, colleagues! The first thing to note in presenting our first-quarter results is that this was challenging time for the oil industry, with simultaneous negative impact from a number of factors: the situation on world markets, changes in tax legislation (more about that later), restrictions on capital markets and, consequently, increased cost of borrowing. In this difficult context, Gazpromneft managed to show positive dynamics on nearly all key indicators and, more importantly, we are continuing to implement all of our strategic investment projects in a consistent fashion. As will be shown, we are on schedule in practically all of our major projects.

Among industrial indicators, production levels are particularly telling. We registered a record production growth rate approaching 15% and, as I will explain, we are looking forward to a quite substantial increase of production for the whole year. Premium sales grew in spite of the difficult overall situation on the domestic market in the first quarter. It is true that refining volumes decreased, but I would emphasize that production of light petroleum products, which we view as the key indicator, remained at last year's level. The decline was concentrated in heavy fuel oil, which is not a priority product for us. Financial indicators also improved. Revenue increased by 2.6%, EBITDA grew by 11.1% and net income available to shareholders was 3.5% higher. Our quarter-on-quarter trend was also positive, though it should be said that the external environment was also better than in the fourth quarter, which was particularly tough for the oil industry. Both external and internal factors played a role.

Let me hand over now to my colleague from upstream, Mikhail Zhechkov.

Mikhail Zhechkov, Head of the Economics and Investment Department at the Exploration and Production Division

Welcome, ladies and gentlemen! I would like to tell you about our E&P results in the first quarter with some details about our main achievements.

Production in the first quarter of 2015 grew by 14.9% against Q1 2014, of which 10.7% was organic growth and 4.2% was non-organic. We expect production growth of at least 10% in 2015 against 2014. We have commissioned the Kulginskoye and East Myginskoye fields and we also expect to start production in 2015 at the South Priobskoye gas-processing plant, which will enable us to improve our level of associated gas utilization by 1.8% and by 12% for the Khantos subsidiary.

We have achieved mutual agreements with our contractors to reduce the cost of services by average 2% in comparison with previous agreements as part of our program to improve efficiency and cost management. We are maintaining our technology leadership in drilling and complex operations, but at the same time we are working this year to optimize costs, making the efficient technologies, which we use, cheaper and more available.

As regards new projects, we had planned 3 tanker shipments last winter at Novy Port, but in fact we managed 7 shipments in February-May. For the summer we had initially planned 5 tankers, but now expect 6. So, having confirmed the logistics we initially envisaged, the current vessel turnaround time allows us an even higher throughput.

We obtained 5 licenses with reserves of 17.3 million tonnes at auctions.

At Badra we have a resolution from the Iraqi Oil Minister to reimburse project costs for the third and fourth quarters of 2014. This is an important event for the project.

The gas processing facility at the Yaro-Yakhinskoye field, with 20 million m³ daily capacity, has been launched in test regime and we have obtained trust management of shares in Northgas. As I have already said, we plan to ship 230,000 tonnes from Novy Port in 2015 compared with 148,000 in 2014. We expect to commission the Yaro-Yakhinskoye complex gas treatment unit with 7 billion m³ annual capacity, and development drilling and production growth will continue at Prirazlomnoye and Badra.

As you already heard, our hydrocarbon production grew by 2.8% in the first quarter of 2015 against the fourth quarter of 2014. Daily production rose by 5% from 193 tonnes to 202.6 tonnes, including 2% for oil and 14% for gas. We are trying to maintain and build on the momentum, which our strategy calls for.

The next slide shows hydrocarbon extraction in the first quarter of 2014 compared with the first quarter of 2015. Here you can see that the growth of 14.9% was due to both liquid hydrocarbons and gas. Growth for liquid hydrocarbons was 6.2% and gas growth was more than 47%.

I would like to say a few words about growth of unit operating costs at mature assets relative to the first quarter of 2014. Firstly, we saw an increase during the reporting period of investments as part of production costs, aimed at intensifying production. That is because we carried out a number of well interventions in the first quarter, which enabled us to maintain efficiency, to keep up the base production level. Also there were fewer days in the first quarter of 2015 when weather made work impossible.

Regarding lease rates. We decided on the basis of total ownership costs that leasing is good for us and for our contractors. So we have made a long-term contract and we are gradually changing over to lease prices. Essentially, this is a reclassification. The fact is that, looking at overall ownership cost, procurement through leasing is much more profitable for us than purchase. Taking those two factors into account growth in the first quarter of 2015 relative to the first quarter of 2014 was just 5%, that is lifting costs. I would emphasize that this is efficient for us because it makes our contracting and work with contractors quite efficient. This allowed us to keep up a rate of 5%.

Next about Yamal. I would draw attention to our successful test production work on oil rims. Daily well production was 300 tonnes per day. The third stage of the Samburg gas-processing plant was commissioned with 2.3 billion m³ annual capacity and we launched a gas-processing plant for the Yaro-Yakhinskoye field with up to 20 million m³ daily capacity. We have also achieved several milestones at Arcticgas: all main capacities have been commissioned, including refurbishment and launch of facilities after the accident in April 2014. The field has been brought into steady commercial operation.

I already said something about winter shipments at Novy Port, and I would like you to look now at the lower part of the slide. In 2015-2016 we are making shipments using leased icebreakers tankers that operate in the Ob Gulf. In accordance with the project schedule, we will mobilize bigger tankers from the end of 2016 as the field comes on stream. That will bring us to our planned logistics scheme.

That's everything I wanted to say. I'll let Vladimir Konstantinovich take over.

Vladimir Konstantinov, Head of the Economics and Finance Department of the Logistics, Refining and Marketing Division

Good afternoon, ladies and gentlemen! Our downstream and downstream business in Russia as a whole had a tough time in the first quarter of 2015. That was due to uncharacteristic proportions between such efficiency factors as price of oil, domestic prices and tax conditions. There were changes in tax law and impact of the export duty lag, which had impact not just on financial results, but also on volumes of oil refining.

Oil refining volumes in the first quarter of 2015 were 10.4 million tonnes, which is slightly lower than in the same period of 2014. The main reasons have already been explained by Alexey Yankevich. I would just emphasize again that, despite a slight decline in refining volumes we showed an increase for light oil products. We produced 2% more high-octane gasolines and 4% more kerosene, and fuel oil production decreased significantly. So reduction of refining volumes did not adversely affect deliveries of petroleum products to the domestic market and we met the needs of our customers.

We kept up our work on the modernization of our refineries in the first quarter of 2015, and took final investment decisions on the deep processing project at the Moscow Refinery, and installation of a delayed coker, crude oil and vacuum distillation unit, and reconstruction of catalytic cracking at the Omsk Refinery. We also launched a gas fractionation plant at the Moscow Refinery. We will continue modernization work in 2015. The project for creation of an complex processing unit at the Moscow Refinery is in the implementation stage: project documentation is being prepared for the hydrocracking and flexi-coking units. We are approaching completion of upgrades at Omsk of Distillation Unit-9 and Catalytic Cracking Unit 1/1. We will also work on the construction of delayed coking and hydrocracking units at Omsk. Our main focus in sales is further increase in volumes of premium sales, which rose by 1.8% compared with the first quarter of 2014. This was largely due to the fact that we have created an efficient chain format. We are reaping the benefits of that and we are also working to make the chain even better.

As in previous years, growth of the Company's retail sales of gasoline and diesel fuel were ahead of the market. Overall, we expect to continue our efforts to improve the filling station chain in 2015. We will acquire stations, build new ones, and carry out reconstruction and rebranding. In the aviation fuel segment we plan to build a refueling complex at Saratov airport, and in bunkering we plan reconstruction of our Black Sea terminal. In the lubricants business we are ready to expand and increase production capacity at the Omsk lubricant plant and we also expect to begin construction of a third-group lubricants facility at the Yaroslavl Refinery.

As I said, the macroeconomic environment has been challenging for Company refining business. In contrast with previous periods, although processing netback in the first quarter of 2015 remained higher than netback on oil exports over the whole of the quarter, the difference was minimal in average terms. We haven't seen anything like this in previous years. There were times during the first quarter when refining netback was lower than export netback. Overall, though, refining remained more efficient than export of oil. Naturally, we are working to optimize refining load by months and by refineries to ensure that refining business is efficient over the period of a quarter.

If we look at the balance of crude oil exports, we can see that trends in refining volumes were not the same at all refineries compared with the first quarter of 2014. There was a decline at the Moscow Refinery and this was associated with the fact that, as I have said, we responded very clearly and consistently to trends in the balance between basic macroeconomic parameters and evaluated the efficiency of oil refining.

You are probably wondering about the reduction of oil refining volumes at the Mozyr Refinery. Our approach in deciding on refining volumes is the same there as at the Russian facilities. Under the agreement on Mozyr, we have the right to supply up to 50% of total crude oil inputs there, and we supplied oil in accordance with the agreement. Refining volume did decrease, but that was determined by the state of affairs on the world market and the market in Belarus. If the situation develops in such a way that the efficiency of refining at Mozyr grows substantially, we will take full advantage of the opportunities and substantially increase refining volumes within the established quotas.

I would like to discuss how we are increasing the efficiency of refining in an unfavourable pricing environment. I would draw attention to indicators for refining depth and light product yield. We have increased processing depth at nearly all our refineries. Several factors are at play here. First, there are major repairs and upgrades carried out in 2014. I am talking here about the Moscow Refinery, where there was substantial reconstruction in the fourth quarter of 2014, and the Yaroslavl Refinery, where there was a large-scale reconstruction of units in the gasoline pool. The second factor is that, particularly at the Omsk Refinery, we have increased inputs of gas condensate, which has led to an increase in refining depth. We view this as an efficient approach in terms of refining volumes and light product yield. The third factor – you may ask whether reduction of refining volumes at some refineries led to increase of refining depth? Yes, but this was not the main factor. With regard to light product yield, the factors are almost the same – particularly those associated with our work to modernize refineries.

As for marketing, I say again that our main task is to increase the volume of premium sales, which in itself means an increase in the efficiency of our marketing business. At the same time we retain and increase our

share of the premium market. Growth of premium sales in our main marketing activity – the sale of motor fuels through the filling station chain – grew by 2.5% in 2015. The total number of stations in the chain increased by 15 to 1825. Our revenues from the sale of non-fuel products and services at filling stations also continue to grow rapidly. For aviation fuel we increased market share by 2.5 percentage points to 27%. We are the leader on the Russian market for aircraft refueling. The number of international airports where we offer refueling services has grown, as well as the number of airports abroad where we provide services to Aeroflot.

We have increased our bunkering market share to 23.2% and growth of premium sales was 5.9%. We have commissioned a large bunkering tanker to operate in the Black Sea. For lubricants we showed 25.5% increase of premium sales thanks our sustained and hard work to improve the quality of our lubricants and the range of products, which we offer. Our share of the retail market for lubricants grew by 5 percentage points to 17.5%. We have opened a new G-Energy service station in Belarus. We are working intensively to increase the number of service stations, which use our G-Energy service. Deliveries of our lubricants to foreign markets have increased.

That is about everything. Let me repeat: the first quarter was difficult, but, in general, we view our downstream results in the context, which obtained in the first quarter, as successful. Thank you.

Alexey Yankevich, CFO and Member of the Management Board

I will now look in more detail at financial indicators. As I already mentioned, revenue grew by 2.5% year-on-year, while it decreased by 5% quarter-on-quarter, due to a certain decline in sales volumes reflecting high base effects and seasonality. In the fourth quarter we sold reserves, but in the first quarter, by contrast, they rose slightly, as usually happens at the beginning of the year. EBITDA and profit increased significantly quarter-to-quarter due to both external factors and internal factors, of which I will have more to say.

Let's look in more detail at the analysis of operating performance, both compared with last year and with the previous quarter. First, as regards comparison with the first quarter of 2014. As I have already said, we can see that the external environment had a negative impact – it worsened. The overall effect was negative 5.4 billion. The main negative factor was changes in tax legislation. It gave more than 20 billion. Minus. It was partially compensated by the weakening of the ruble. We were able to improve financial performance thanks to actions by management. There was a significant improvement, worth almost 15 billion, from growth of production (organic and inorganic), optimizing of production structure and sales, and growth of premium sales.

The trend is also positive if we analyze results in relation to the previous quarter. But some improvement in the external environment relative to the very poor fourth quarter was a significant positive factor here. The duty lag played its part again, but in reverse – it was positive, and had quite a strong influence. And the weakening of the ruble. These factors essentially gave growth. But we also managed to improve the financial result thanks to internal factors. The increase due to internal factors was about 9 billion. It includes production growth, including new upstream projects, and optimization of production and sales.

Going onto cash flow analysis. This is the only sphere where our result is, let's say, not as good as it might be, as you probably noticed. Operating cash flow declined in the quarter relative to last year, from 70 billion to 60 billion. This is because we had a quite significant reduction of accounts receivable in 2014. It was a one-off effect of the sharp drop in oil exports, which reduced receivables. This year, by contrast, receivables increased slightly, which was due to growth of our premium sales. These sales are largely by instalments and this effect gives the figure of 10 billion rubles. Also, what we have shown here is so-called adjusted cash flow, which is a bit different from the figure in the IFRS statements. The statements show an amount of 55 billion rubles. The difference of 5 billion rubles reflects our work at the Messoyakha group of fields, where we have a 50-50 joint venture with Rosneft and we are the operator. As operator, we bear all the costs, which are then reassigned to the joint venture. And this figure is the time lag that occurs between the step when costs are incurred and the step when they are reassigned to our joint venture. So, in principle, this figure will become a part of our investments in Messoyakha, we have administratively transferred this figure and returned it back to operating cash flow. In essence, it is not operating cash cost. Rather, it is an investment in our new projects. So, at the same time, this figure fell into the "new projects" line, into the negative part of cash flows.

While operating cash flow declined somewhat, investments, on the contrary, substantially increased. We are now in the most active investment phase. We have spoken about this at numerous meetings with our investors and analysts. You know that we are preparing for launch of several very large fields. Novy Port and Messoyakha are both at the final stage – we need to commission them next year. This amounts to very large capital investments that we need to make, but the situation is temporary. It is what has caused free cash flow to turn negative. On the one hand, there is the adjustment of operating cash flow and, on the other hand,

increase of investments. But this transition to negative cash flow is temporary. The situation will change with the commissioning of large new fields. They provide a fairly large relative cash flow, so their entry into industrial production will give a significant increase of operating cash flow, bringing our free cash flow back into positive territory.

What the next slide does is precisely to show the trend in our investments: they have increased significantly. The main growth driver is increase of investments in our new fields, as well as a certain reclassification. Notice that the Priobskoye field has entered the group of mature fields, as it has passed the production peak. So the volume of investments in brownfields increased. This is a classification factor. If we remove Priobskoye, growth will be around 7%, plus or minus on the inflation level. But if we look at investments in new fields and take out the Priobskoye factor, we see substantial growth. Using comparable figures 12 billion rubles without Priobskoye up to 22 billion this year, again without Priobskoye. Key factors are Novy Port and Messoyakha and also the Prirazlomnoye field. For other investment areas there is no change, plus-minus. The slight decrease in marketing is due to completion of the greater part of our upgrading and rebranding program. That explains a certain correction of investments in these items.

I will end the presentation with the slide on our debt portfolio. I would emphasize that, despite the very difficult situation on financial markets in the first quarter (now somewhat improved, but still quite challenging), we feel fairly comfortable. As you can see, most of our redemptions are in a three-to-five year period. Now, in the near future, we do not have to settle very large sums. That is one thing. The other thing is that we managed to complete very satisfactory transactions this year and at the end of last year, mainly with Russian banks, as you know. The institutions in question are Rosselkhozbank and Sberbank. Now we have practically signed a deal with Promsvyazbank for a program to refinance foreign currency loans, in association with the Central Bank. We don't have any draw-down yet, but we have agreement in principle. If a decision is taken the loan will be available. We are also working on other instruments. Generally, though, our needs for this year are covered and we have started work for the future, which includes work on the Asian market and the domestic market. We are looking at all the possibilities that exist.

I will finish my report on that note. Once again I would like to say that we view the first quarter results as good. Despite the difficult situation, Gazprom Neft remains a growing company. We reaffirm our strategy and we are significantly increasing production, as planned. This year we expect double-digit growth of production, which is in line with our strategy. All of our major projects, both in production and in refining, are on schedule.

Thank you for your attention, we are ready to answer your questions.

Q&A

Question No.1

Maxim Moshkov, UBS

Good evening! I have a few questions. Could you clarify the production plan at Prirazlomnoye this year? That is the first question.

The second question is about the start of condensate supplies to the Omsk Refinery, which has even led to an increase in net product yield at the Refinery. I understand that this is condensate from SeverEnergia (Arcticgas) fields. Can you tell me how much condensate you plan to supply for refining at Omsk in MMtonnes per year?

The third question is about Mr. Dyukov's comments at the meeting with Medvedev at the Gubkin Oil & Gas University, where he said that reserve quality has worsened substantially, including at the Priobskoye field. This deterioration is likely to lead to an increase in capital investments at constant production volumes. A major increase in the volume of capital investment spending is visible. Will this trend continue or has capex at the Priobskoye field already reached some kind of peak level? Thank you.

Alexey Yankevich, CFO and Member of the Management Board

Maxim, thank you very much for your questions. We will reply to the first and the third questions first, about the production plan and situation at the Priobskoye field. I will ask my colleagues from upstream to provide answers, and then Vladimir Konstantinovich will answer your question about gas condensate.

Mikhail Zhechkov, Head of the Economics and Investment Department at the Exploration and Production Division

Regarding Prirazlomnoye, the first question. We are planning to produce 860,000 tonnes of oil equivalent in 2015. As for the Priobskoye field, I will ask Alexander Listik, who deals with geology and development in the production directorate, to comment.

Alexander Listik, Head of Well Intervention Analysis and Monitoring of Investment Projects

Good afternoon! Yes, we are starting on more difficult areas as the Priobskoye field. The reservoirs are thinner, the oil saturated strata are smaller and have reservoirs that are of worse quality. But in 2014 we had 168 horizontal wells with multi-stage fracks and this technology is getting better well by well, as regards the work itself and well completion methods. So in the near future we can keep up the flow rates at launch that we were achieving previously from thicker reservoirs, where we drilled non-vertical wells, and reduce the fall rate thanks to technology improvements. At present we are also looking at application of dual-bore wells. We are working closely with Schlumberger, which has the relevant experience. If we can obtain positive results, these technologies will be tested and replicated at Priobskoye.

Mikhail Zhechkov, Head of the Economics and Investment Department at the Exploration and Production Division

Colleagues, let me add something about capital investments at the Priobskoye field. Generally speaking, we do not expect growth. As Alexander said, we will use new technologies, we will drill new wells, but flow rates will be greater. So there is a delicate balance. So the answer to your question is that we have no plans for growth of investments at Priobskoye in the next three years.

Vladimir Konstantinov, Head of the Economics and Finance Department of the Logistics, Refining and Marketing Division

The question about gas condensate. It is correct that we have substantially increased condensate refining. The condensate is from various sources, including from SeverEnergiya, as you say. We plan that total volumes of gas condensate refining in 2015 will be double the level last year and will be about one million tonnes. Gas condensate will be refined at the Omsk Refinery.

Question No.2

Pavel Sorokin, Morgan Stanley

Good evening and thank you very much for your presentation. I would like to ask two questions. One small clarification about condensate. Is this condensate that you buy from Novatek, from SeverEnergiya, or do you buy it directly from Arcticgas?

The second question is about downstream and has several strands. In the new environment and having worked for the last 5 months with the new tax legislation, do you have some understanding of how your plans for refinery modernization and expansion in premium segments might change? Could you give figures for planned investments in these segments over the next two years? Thank you.

Alexey Yankevich, CFO and Member of the Management Board

Thanks very much for the questions, Pavel. I will ask Vladimir Konstantinovich to answer regarding refinery modernization, and I will say something myself about gas condensate.

Vladimir Konstantinov, Head of the Economics and Finance Department of the Logistics, Refining and Marketing Division

Yes, colleagues, we looked hard at our modernization plans in view of the changed macroeconomic situation and decided to keep our plans for refinery modernization, in principle, in spite of the change. We will implement all of the major projects that we have planned: at the Omsk and the Moscow Refineries. Investment volumes are being settled depending on how projects develop. As regards timing, there might be some postponements of implementation, but, I repeat, all of the major projects will be implemented. And you probably know, or have read in the press that our obligations for implementation of major projects remain in force.

Alexey Yankevich, CFO and Member of the Management Board

To answer your question about gas condensate. What we supply to the Omsk refinery is, essentially, our share of gas condensate. It does not go through Novatek, we buy it from the joint venture.

Pavel Sorokin, Morgan Stanley

Thank you very much for your answers.

Question No.3

Alexander Besimalov, Citibank

Hello! Thank you very much for your presentation. I have a question about refining margins. I understand that the first quarter was challenging due to a combination of several factors, including changes in tax law. What trends do you see right now, at the end of May - beginning of June, in terms of refining margins? How do you see the second half of the year? Are margins recovering and is it possible that part of the lost margin will be restored due to increasing prices on the domestic market? If possible, let me know in actual numbers how you see margins. Thank you very much!

Vladimir Konstantinov, Head of the Economics and Finance Department of the Logistics, Refining and Marketing Division

I would say that giving forecasts in terms of numbers in a situation where macroeconomic factors change by dozens of percent from month to month is not very helpful. You probably know that Brent rose by 5-6 dollars per barrel in May compared with April, which is a very significant increase at the current price. There is the duty lag and there are price trends on the domestic market, so it is very difficult to say what the margin for our refineries will look like by the end of the year. I would like to say that our refineries are efficient and they came through the first quarter quite well. And it was a very difficult quarter. The margin situation now is easier, nearly all of our refineries are in positive territory now. And we expect margins to stay positive for all refineries to the end of the year. As regards margin comparison between refineries, Omsk will be the most efficient, as it was before. Margin there will be fairly high. But, of course, it will be lower than last year at all refineries. We expect positive values for the whole year at the Moscow and Yaroslavl Refineries. We will respond quickly to optimize our oil flows and distribute them between refineries and exports. Thank you.

Anna Sidorkina, Head of Investor Relations

Anna Sidorkina, Investor Relations. Thank you very much, colleagues, for your interest. It seems to me that our managers have given a very detailed account of all the events in the first quarter and offered the forecasts you need for the future period. Thanks to all of you for taking part!

Best wishes.