JSC Gazprom Neft

1Q 2012 Financial Results
May 22, 2012

Anna Sidorkina, Head of Investor Relations

Good afternoon, ladies and gentlemen! Please allow me to start this conference call, where we are going to disclose the financial results of the Company covering 1Q12. This is the first time that we have published it in accordance with the standards of International Financial Reporting. First of all I would like to introduce the participants of our teleconference. We will have comments and presentation after the financial report given by the member of the Management Board and Deputy CEO for Economics and Finance, Alexey Yankevich; with respect to Upstream operations during the reporting period we will hear from Vadim Yakovlev, First Deputy CEO, Deputy Chairman of the Management Board of Gazprom Neft; then Vladimir Konstantinov, Head of Economics and Investment Department of Downstream. Following that during Q&A we will be joined by Head of Strategic Planning Department, Sergei Vakulenko.

Before we start our presentation, which you can see on the website, it's a webcast delivery, I would like to remind you once again that the presentation that we're going to give you today and any comments today and any statements given to you during the conference call may contain forward-looking indicators that relate to business of Gazprom Neft and its results. So any statements other than statements of historical facts are or may be deemed to be forward-looking statements. So forward-looking statements are things of future expectations that are based on management's current expectations and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in those statements during this conference call.

Now please allow me to pass the microphone over to Alexey Yankevich.

Alexey Yankevich, CFO

Good evening ladies and gentlemen! As Anna Sidorkina told us, indeed this disclosure of our report is not very usual because it's the first time when we do that under the IFRS standards. So that is exactly why we are doing it slightly later than we did it in the past and as you have noted so far we have uploaded only our MD&A and the presentation. Auditors are finishing the last formalities and later today you will be able to see the full report including the audit opinion. I can very much assure you that all of the figures, which are in the report, are final. The figures won't change, it's just that the very last procedures are going to be completed and we are expecting to receive a formal letter from the auditors today in the evening. Apart from switching to the new standards we also have taken care to do the maximum possible disclosures so that you could find it easier to switch from our GAAP reporting to the IFRS. All of the reconciliations and the recalculations have been made available and apart from the traditional quarters which we compare, such as the first quarter of last year and the fourth quarter of last year, we have also included the second and the third quarter information. So you can see a complete restatement of our financial statements under GAAP and under IFRS for last year. Then you can change the data in your models and fully rely upon the IFRS reporting in the future.

Now we'll switch over specifically to our results. Despite the lengthy process of preparing the report, I believe that the results are good. In Q1 all key indicators are up: the revenue has grown by 20% , the adjusted EBITDA including share in the associated companies has grown by 11% , net profit has grown by 21%. We also saw our operational results growing: the sales indicators are up, the hydrocarbon production has grown by 6%, the refining has grown by 8%, the premium channels sales continued showing significant growth and Q1 demonstrated 33% growth compared to last year. At the same time the retail throughput per one retail site has grown by 36%. One of the main events of the first quarter that we have started producing gas under the SeverEnergy project. We have launched the first stage of the gas processing facility at the Samburgskoye field and currently started delivering gas, 6 MMcm per day is being pumped into the Gazprom general gas transportation system. We are expanding our retail network and in Q1 we have acquired additional locations in the North Western region. We have completed the deal in Chelyabinsk. Also we have commissioned quite a large refuelling complex at Sheremetyevo. It was a big project related to our strategic airport. So we are expecting considerable growth in premium sales and revenue in this segment. We also signed a significant contract with Chevron to produce modern marine engine oils which gives us an access to Chevron modern technologies to produce highly effective lubricants for marine vessels. We have also registered growth of indicators on quarterly basis: in revenue it was 2%, adjusted EBITDA has grown by 2.5% , also the refining volume has grown. Production went down slightly, but that was more of a seasonal factor and Vadim will tell us more about it. We have positive outlook for the whole year and we would be reaching good results at the year end.

Next I would like to say a few words about the macroeconomics and about the main trends over the first quarter from the point of view of the external environment. In Q1 global crude oil prices continued to grow, the average price reached $118.60 per barrel, but at the same time a number of events occurred which brought about some changes in the crude oil and refined products markets, that also affected the refining margin. Apart from the crude oil price growing, you know, that in Q4 new "60-66" tax regime was introduced and traditionally with the changes in the crude oil price we have a certain lag in terms of the duties. Looking at the chart you may see that against the oil price growing the duty which is established according to the formula was running behind the figure which could have worked out if: firstly, there wouldn't have been the "60-66" new tax regime and, secondly, the duties would have been established on the very day. So Downstream netback would have shown much more considerable growth if it wasn't for the duty lag and the "60-66" regime. But at the same time domestic prices in the course of 2011 were growing but at a slower pace and by 1Q12 they have achieved a certain equilibrium despite the global prices growing. It can be explained by the fact that the shortage that we saw in the domestic market was more than compensated by many companies launching respective units within the product quality projects. There have been more of the refined products complying with the technical regulations so the refined product supply in the domestic market grew taking into account the fact that traditionally in Q1 the demand is not very strong. All of this added to the outcome that in 1Q the prices have stabilized and taken up the

level of 4Q11. As far as excise is concerned, on the contrary, in Q1 they have grown considerably because the excise rates changed as of January 1st 2012. So these factors led to the refining margin going down if you want to compare it both to the last year, Q1 and Q4. Refining margin has shifted to Upstream and, if you take a look at the profitability of the separate segments in our business, you can see that the upstream operations showed serious growth like in the case of the joint ventures because most of them are in Upstream. So the profit of the company, which we recently have published under Russian accounting principles (it includes refining margin), went down.
With that I would like to pass the microphone over to Vadim Yakovlev who will give us more comments about the upstream operations. After that will be the Downstream section and then I will go back to the finance.

Vadim Yakovlev, Deputy Chairman of the Management Board, First Deputy CEO

Good afternoon ladies and gentlemen. Looking at the results of the first quarter I would like to say that we are positive about them. Good dynamics have been achieved in terms of the level of production in comparison with 1Q11. Aside from that I would like to note that our major projects are running exactly at the speed that we had planned for them and apart from that we have achieved certain results which considerably alter for the better our expectation for a number of the major projects. First of all I'll dwell on the basic events with respect to all areas of our operation, in terms of the brownfields as well as the major Russian greenfield projects and the international projects as well.
Now with respect to brownfields, our efforts have been aimed at identifying additional opportunities to maintain and increase production volume. We are seriously working over increasing the technological effectiveness of our operations. We expand our horizontal drilling work, something that I will mention again later. We are increasing the efficiency of the horizontal drilling by applying the modern system of geosteering and the real time support for the drilling as well as increasing the complexity of the horizontal well structure. I would also mention, at the Priobskoye field we have been able to increase the initial flow rate for new wells, it has been 36% Y-o-Y. We have been able to achieve it by optimising the hydrofracturing design. We were able to extend the half-length of formation fractures thus expanding the drainage area. Also we optimized the time for the well to injection fund and consequently we optimized the status of the sub-surface pressure maintenance system.
As for major projects, we also re-entered the first well at Novoport field. We have achieved a very good flow rate at the level of 140 tonnes a day with the potential for further growth up to 300 tonnes a day. We also re-activated a well with application of the hydrofracturing at the Tympuchikanskoye field. Also we have enjoyed the very good output at the level of 120 cubic metres a day with the potential for further growth up to 200 cubic metres a day and I should note that previously at this field the outputs never exceeded 15-20 tonnes. What we've achieved right now significantly changes our outlook for the future of this field. With respect to Messoyakha we are moving at the expected pace. We have completed our seasonal seismic and started drilling in May. In Orenburg we have finished the first pilot drilling project of the six wells and we have achieved good results. We are now in the process of data evaluation and we are preparing expansion of our drilling program. So

the next pilot will include more than 20 wells. And the main event in terms of major project implementation is the start of gas production at SeverEnergy fields.
As far as the international projects are concerned I should note the continued growth of our production in Serbia, 11% Y-oY. We have already mentioned that we have expanded our presence in the Balkans and entered into a number of international projects. In the first quarter we have started drilling in Hungary. We completed seismic in Bosnia and Herzegovina and we are now interpreting the data. At Badrah we have expanded drilling, we are doing it now with three rigs. Besides we started drilling also in Venezuela at Junin-6. So these are the main events with respect to our major projects.
The next slide please, production dynamics compared to last year and Q4. Output volume demonstrates almost 6% incremental growth Y-o-Y, which has been achieved by consolidating the Orenburg assets, by increasing the output at the Priobskoye field as well as the start of production drilling at the group of Luginetskie fields which we have acquired quite recently from Malka Oil. In the first quarter compared to the fourth quarter we have registered a slight decline within the 2% which is related to a seasonal change in the level of activities at our fields. Then it is in our plans to achieve a 4% growth as opposed to the current level of the daily output by the end of the year (by Q4).
Further I will say a few words about our cost dynamics. With respect to the operational costs the results are good. We have managed to achieve a reduction of the unit costs by 2.7%. As has already been mentioned we have switched to IFRS and therefore the exchange rate doesn't affect our dynamics anymore. Certainly we have been affected by such factors as the natural monopoly tariff growth, industrial inflation but despite the negative effect coming from these factors, the overall dynamics was a positive one. So we have been able to compensate the negative effect of the external factors by our own efforts of cutting costs. So overall throughout the year, I should say, it can hardly be taken as the guidance for the whole year because the results of the first quarter quite often cannot be accepted as indicative with respect to the overall year results but we will be doing our best to demonstrate the overall dynamics which should be better than the average industry one. CAPEX growth was 9% Y-o-Y which, I believe, is a good one, considering the fact that we have been investing more into the development of our major projects and we have managed to reduce the capital expenditures per barrel of output of brownfields by optimising our technical solutions and through the reduction of costs related to drilling.
Next I intend to tell about the application of new technologies. The main volume of drilling certainly is the vertical and directional and it's about 50-70 million rubles per well. Well flow rate that we achieved is in the range of 30-50 tonnes per day. Our main emphasis for the current year is to increase the amount of horizontal drilling operations and upon this slide we have tried to demonstrate what could be the efficiency that we may gain from growing the horizontal drilling volume. You may see that the level of costs per horizontal well has been growing up to 70-90 million rubles per well, in other words within the range of up to 80%, but at the same time the growth of the average flow rates considerably exceeds the level of costs. The outputs that we achieved in the case of horizontal wells fit into the range 70-200 tonnes so output growth considerably exceeds additional costs related to making the well design more complicated. Last year we drilled about two horizontal wells per month, the level that we've obtained right now is seven such wells per month and for the

second half of the year our plan is to drill about ten such wells per month. Besides we raised the level of drilling technologies, the complexity of the design which either achieves additional efficiency growth, you can see it upon this slide for example in terms of the dual-leg wells and of the horizontal wells with the multi-stage fracturing or makes it possible to bring into the development the reserves which without the application of such advanced technology solutions would simply not be commercially viable. Specifically we are talking about edge zones with low formation thickness and low permeability. So in our plans we intend to expand the application of the horizontal drilling technology with a multi-stage fracturing in order to turn hard-to-recover reserves into profitable ones. As for wells with multi-stage fracturing, we didn't drill such wells previously but in Q1 we did the first one and currently we are working on the second well, and before the end of the year we plan to drill ten more. At the current stage it is a pilot area of work. So we appraise our results, we optimise the well design in order to spread these technologies and to apply them for our hard-to-recover reserves. With respect to the dual-leg wells, throughout the whole history of Sibneft and Gazprom Neft about four wells like that were drilled, in the current year one well was drilled , there's another well that is being worked on and before the end of the year we intend to drill 12 wells which is more than throughout the whole history of the company.

You can see the results in terms of all types of horizontal drilling, so you can note that flow rate growth considerably exceeds cost increase and apart from that it enables us to bring into development the reserves which without the application of such technologies cannot be reached.

Finally, I already mentioned it, we have been able to raise the average flow rate of the new wells at the Priobskoye field. The growth was 36% Y-o-Y. Besides I should note that generally the Priobskoye field continues to demonstrate incremental growth and we expect that it will continue as a minimum until December 2012. By the end of the year together with preparing the business plan for the next year we would be able to receive the appraisal of production profile for 2013. But what we see right now, it shows that this growth will sustain through 2013 as well.

This is it and I am passing the microphone over to Vladimir Konstantinov.

Vladimir Konstantinov, Head of Economics and Investment Department, Refining and Marketing division

Good evening ladies and gentlemen! The principal task for Downstream in the first quarter, like in 2012, is to ensure considerable growth of the Company's financial results by increasing sales efficiency. It may be said that this task is being done substantially by Downstream. I shall remind of the growth in the premium sales (+33%) and that growth was brought about not by increasing the number of retail locations, they grew but not considerably, but by increasing the average sales per one site and, apart from it all, through the considerable growth of unit premium sales in other segments. We were able to achieve such results only because we have come to completion of a rebranding program for our retail sites during Q1 2012. The rebranding of sites changed not only the style and the outlook but also sites were renovated considerably. Also the other effect of the completion of rebranding program is a very high rate of non-oil sales - 52% of growth in 1Q12, which is much faster than the unit sales growth in refined products. So in order to ensure such high rates of growth for premium sales we have grown our refining by 4% but that was not the main thing.

In the first quarter we were executing the product quality increase program consistently. A very iconic event in this area is the start of the production of the 4 and 5 Class gasoline at Yaroslavl refinery. Also it is a 2.7% growth of high-octane gasoline production at our Russian refineries. In terms of launching the new facilities for increasing the product quality it's quite notably that we began commissioning of FCC gasoline hydrotreater at Omsk refinery. In 2012 we intend to complete the quality program at three of our refineries: at Omsk refinery, at Yaroslavl refinery and at NIS, where a complex hydrotreating and hydrocracking units will be introduced into operation. It will naturally increase the level of our premium sales and will bring a considerable growth of financial results by the effect of saving on excises. As far as the completion of the quality program is concerned, we intend to accomplish it in 2013-2014 when isomerization unit and FCC gasoline hydrotreater will be commissioned at Moscow refinery.

Now we switch further to page 16. We can see that the implementation of the quality program has already affected the structure of petroleum product output. In 1Q12 production of 4 and 5 Class gasoline increased by 2.6 times amounting to 22% from the total amount of gasoline production. As for diesel, production growth of the high-quality diesel amounted to 50%. Naturally this fact affected the financial results. Only in 1Q12 we have gained about RUB 0.7 billion from changing the production structure of gasoline and diesel in terms of quality.

Once again I would like to draw your attention to the fact that we are improving our retail network, we are developing our sales structure and the Company share in the market of petroleum products is growing.

Now if we take a look at the next slide, we can see that our share in the main markets grew from 9% up to 11% in terms of the retail sales of petroleum products through the filling station network. Also our share of lubricants sales demonstrated growth and actually the general growth was 14%. The jet fuel sales increased by 49%, accordingly our share in the Russian market increased to 19%. The bunker fuel sales increased by 69%, it is the highest rate of growth out of all areas of our marketing business and our market share reached 18%. Also I should say that we are the leaders in selling of bitumen in the Russian market, our share is about 33%. Again I must note that this growth has been achieved primarily not through growing the number of our retail network facilities but through the improvement of "per unit" sale indicators. As far as acquisitions are concerned, in 1Q12 they were not very substantial. We acquired six filling stations in St. Petersburg and introduced into operation the refueling complex in Sheremetyevo Airport. In 1Q12 these acquired facilities have been operated actively and already demonstrated their results.

So very briefly, this is the results of Downstream operations for the first quarter of 2012.

Alexey Yankevich, CFO

Ladies and gentlemen, we are continuing our presentation and I would like to go back to the Company's financial results. As I said, we are pleased with the financial results. All basic indicators grew compared to 1Q11: the revenue grew by 19.8%, adjusted EBITDA by 10.6% and net profit grew by 21%. This became possible thanks to the increased volumes in production, refining throughput and sales, as well as optimisation of the sales structure and cost optimisation. And all of it despite the fact that the domestic prices haven't grown like we could expect and respectively we haven't achieved the would-be profit. We also have achieved growth on the quarterly basis: revenue grew by 2.2%, adjusted EBITDA grew by 2.5% and net profit grew by 32%. This considerable growth in net profit was achieved first of all thanks to the fact that we have been able to utilise the regional tax exemptions that are being granted in the areas of our presence on the production side. As I said, a considerable re-allocation of profits took place from downstream into upstream. Whereas downstream profits are concentrated in areas where we don't have tax exemptions, then upstream profits are in the tax exempt regions and so our effective tax rate went down in 1Q12. Besides we have gained positive results from the exchange rate changes in our credit portfolio which is denominated in US dollars primarily. It went down in its overall burden due to ruble appreciation and so consequently we recorded a FX gain.

Traditionally we perform a very thorough analysis of EBITDA comparing to the previous year, the previous quarters. So in comparison with our results for 1Q11 we can see that the effect from the external environment wasn't very considerable despite the considerable growth in the global oil prices. So mainly the oil price growth has been compensated by the export duty raise and, most importantly, by MET raise that was up not only because of increase in prices but also the base MET rate went up according to the new law of MET indexing through 2012 and 2013. Respectively the effect from the external factors was 1.8 billion that is just about 2.5% from our financial result while the overall positive dynamic is 10.6%, so about 8% has been gained as the result of the efforts by the management, the growth of production volumes, the outrunning growth of premium sales as well as the optimisation of business processes and the cost reduction. Analysing the dynamics, one can note that effect of the external environment is turning into negative comparing to the previous quarter. It can be explained in the first place by what I already described at the very beginning. It is the stabilisation of prices in the domestic market against the background of the oil prices demonstrating growth, so the growth of the export prices practically has been fully compensated by higher MET rate and taxes, higher transportation tariffs (Transneft, Transnefteproduct and the Russian railroads), so in sum the external environment produced a negative effect. At the same time our efforts to optimise our business, increase volumes of the premium sales and expand our refining throughput compensated the negative effect from the external environment. The good results of our joint ventures enabled us to achieve this positive dynamic as opposed to the previous quarter.

Apart from good results on the profit side I would also like to boast of our good cash flows because I recall you have been critical of us during the previous quarter for weak operating cash flow. So like we said the situation in the fourth quarter was not an indicative one. In Q1 we see the reverse situation, we see a very strong cash flow (more than RUB 62 billion) and more than $1 billion in terms of free cash flow net of investments. We also received an additional cash flow as a result of the loans being returned from our joint ventures that are our major Upstream projects, primarily SeverEnergia, which we've funded by providing with loans. As the syndicated loan was obtained, these loans were returned that was an additional cash flow in the amount of RUB 4 billion. That again shows that it is better to analyze free cash flow for the whole year. However the negative trend of Q4 has not been confirmed and so further on we are planning to demonstrate good cash flows.

Now speaking about investments, investments grew comparing to the previous quarter and the last year. Probably it is not quite right to compare with the previous quarter because in investments, particularly in Upstream, there are some very strong seasonal factors. But in comparison to the previous year, the growth has been considerable in terms of the organic CAPEX. It has been compensated by the one-off transactions of the last year which were related to the acquisition of non-controlling interests in NIS and Sibir Energy. During this quarter we didn't do any deals like that and so the overall amount of investments went down but at the same time our organic investments grew.

The highest growth we see in refining, almost 240%, which can be explained by the ongoing modernization program at the refineries and the quality improvement of products. The modernization of Moscow refinery, which traditionally lagged, now is moving at the outrunning pace. At Omsk refinery a number of major units were introduced into operation and partly the construction of units is near to completion, therefore we see the growth. Besides we plan the commissioning of deep oil processing unit at Panchevo, so we see higher level of investments into refining.

Now with respect to Marketing, investment growth comes from the expansion of our retail network. Like I have explained, we have acquired retail sites in St. Petersburg, we have completed our deal in Chelyabinsk and we also completed the construction of several retail sites in the North-Western region. On top of it we are actively pursuing a program of expanding and upgrading the retail network in Serbia that also affected the overall investment growth into marketing and sales.

We continued to grow our investments into the greenfield projects, we are actively investing in our new upstream projects. The investment growth into our brownfields is explained by the fact that last year during Q1 our level of investments was unusually low because of very difficult weather conditions. But this year the weather conditions turned out to be much better and we have prepared ourselves more thoroughly and the schedule for drilling and workover operations was prepared, so the figure of Q1 turned out to be 23% higher Y-o-Y. But overall throughout the year we believe that it would reach an equilibrium.

Switching over to the financial results, you already know that we work over optimising our loan portfolio and we have set ourselves a task not only to reduce the effective interest rate but also to extend our loan portfolio further to reduce the share of short term debt. We should state that the share of short term debt has grown slightly in 1Q12 but that is a technical thing because this year some of our loans in our credit portfolio are reaching maturity and so there are a number of repayments scheduled. So consequently once they take place, the amount of short term loans will go down again and we don't see anything dangerous in it. We are not planning any pre-term payment because we have got quite a good interest rate, it is a record low one. I should say that 3.34% is a very good figure. Taking into account the fact that the investment program primarily is being pursued from the point of view of the cash flows in the second half of the year we expect that this money is something that we would really find handy.

With that I would like to complete the presentation and we are ready to answer your questions.

Questions&Answers

Andrey Gromadin – JP Morgan

Good evening, thank you very much for the extensive presentation. I have only one question: it's quite difficult to analyze the numbers in rubles, so the question is about the share in the net income of JV. As we can see from the disclosures, the net income increased substantially, the increase was more than RUB 10 bln, but EBITDA according to my calculations increased only by RUB 8 bln.

Could you clarify it? Maybe there was an one-off gain (revaluation). Please give us some details, if there are any. Thank you.

Alexey Yankevich, CFO

I'll answer this question. It's true that the change in the net income and EBITDA was not 1 to 1, but the difference is not very substantial and. As you can see from our financial statements, the net income of our JV increased from 1.7 to 12 bln, that equals to 10 bln. At the same time EBITDA grew from 10 to 18 bln, which is 8.3 bln. The difference is not very material and it is due to the same factors as ours. Firstly, it is a positive FX gain, the revaluation of the Slavneft's debt portfolio from US dollars to rubles. And secondly, it is a decrease of effective tax rate related to the fact that Slavneft enjoys the exemption in KHMAO, so the effective tax rate is lower than the statutory income tax rate.

Konstantin Cherepanov – UBS

Good evening, thank you for the presentation. So the question is basically about the new technologies and specifically about the more active application of the horizontal drilling practices. The question is because of the fact that you have started more actively to drill the horizontal wells, how that may affect the Company's guidance respectively the capital expenditures for this year? And another related question about a technical nature. The flow from horizontal well is much bigger than from vertical one, and it is quite rational. But what we are thinking that later on the output from such wells may dramatically and quite quickly go down. Could you please comment on whether there is something to expect?

Vadim Yakovlev, Deputy Chairman of the Management Board, First Deputy CEO

Konstantin, thank you for the question. So about the budget of the capital expenditures, we are not planning, at least at this stage, to reconsider the amount of capital expenditures for the current year, because here we have to say that partially we already have planned these particular activities when preparing the budget for the current year. And secondly, budget optimization, that is taking place, goes in the framework of the amount that have been approved for the whole year. As of the possible effect to production upon the subsequent output from the horizontal well, quite naturally we are appraising the output from horizontal drilling not only initial flows but we also simulate the production profile throughout the whole life cycle of the use of such wells. The way we do it: we do the prospective model for the every horizontal well and we can understand and simulate the whole period of well's development, we can plan the maintaining of the sub-surface pressure. So this way we achieve the understanding that the accumulated effect from the horizontal well's drilling is greater than the alternative in the substance of traditional vertical and directional drilling. So we do not optimize only the output for the current year but we plan the optimization's activities for the overall field development throughout the whole development period.

Darya Kozlova – RMG Securities

Good evening. So the question is about the free cash flow. In the last quarter you had the increase in working capital. So meanwhile we have not got a full reporting it would be interesting to know what was the situation with your working capital during this quarter. Thank you.

Alexey Yankevich, CFO

Alexey Yankevich is answering the question. The working capital in the first quarter reduced and this reduction was RUB 12.6 bln or 8%.

Anna Sidorkina, Head of Investor Relations

Ladies and gentlemen, thank you very much for joining us for this conference call. Many thanks to the representatives of our Management that they came and answered all of your questions.
So if you have remained questions please call us or write to us. Once again thank you very much and goodbye.