



PJSC Gazprom Neft

Financial results in Q1 2017 24 May 2017

Anna Sidorkina, Head of Investor Relations

Good afternoon, ladies and gentlemen. Anna Sidorkina, Investor Relations. We are pleased to welcome you once again to our conference call on operating and financial results for the first quarter of 2017. Allow me to introduce those taking part in today's call: Alexey Yankevich, CFO and Management Board member, will speak about finance; Alexander Mikheev, Head of Economics and Investment in our Upstream Division, will tell you about upstream business; and Vladimir Konstantinov, head of the Downstream Economics and Investment Department, will talk about Downstream. And our colleagues from various departments will join us for the Q&A session.

Before starting the presentation, which you can view online on our website, I should remind you that the presentation and all comments made during the presentation may and will contain forward-looking statements relating to the financial position, results and business 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 both 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 today.

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

Alexey Yankevich, Chief Financial Officer

Good afternoon, ladies and gentlemen. Today I will present the results of Gazprom Neft in the first quarter of 2017. I think I can say with confidence that the results are good. Net income was at a record level. Our operating income increased by 22% from the previous year (due entirely to organic growth), while net income grew by 49% and, as I said, reached a record level of 62 billion rubles. I should mention that, technically, we showed net income of 73 billion in the second quarter of 2015, but that included one-off paper effect from write-off of promissory notes, without which the figure was under 60 billion. So it is right to say that net income set a new record for a single quarter. As regards production indicators, lifting volumes were much increased, by 4.8% from a year earlier (despite all the difficulties that our Company and the industry had to face in the first quarter, which I will discuss later). Throughputs at our filling stations increased, which is a major driver of business efficiency. Refining volumes were down, but that was a planned reduction, associated with the large-scale repair and reconstruction programme, which was scheduled for the first quarter. Carrying out repairs during the winter, when demand is low, is technically more difficult, but it is better in terms of economics and better for the market. So it was the right approach overall, and it explains the decrease in refining volume.

The positive results were mainly due to successful launch and development of our new projects. We have successfully launched the Novoport and Messoyakha fields, we continued the programme of drilling and production growth at the Prirazlomnoye field, as well as developing our other assets. So we not only have growth of overall lifting volumes, but also a qualitative shift, with growth in the share of production at new, more efficient fields. The share of production at new fields has grown from 4% to 10%.

As regards the trend compared with the previous quarter, you have to remember that the first quarter is very specific and it is difficult to compare with the fourth. Firstly, as I already said, there was the large-scale repair programme, which made it impossible to keep up the results of the previous quarter. Secondly, there was the harsh weather that we had at the beginning of the year, mainly affecting logistics at Novoport, which is particularly susceptible to weather. That restricted our ability to deliver and lift oil from the Novoport field. The weather conditions also affected lifting in some other regions where we have established production, and that also influenced production volumes. But what is important to note (and we will expand on this later) is that we are now catching up with the backlog, production has increased in the second quarter compare with the first. Specifically, at Novoport we are now shipping and exporting more each month than planned, if you take the



plan and divide it by 12 months. So the backlog is being reduced and we are confident that, for the year overall, we will meet the target for shipping and lifting from the Novoport field, and for overall lifting as announced. So those are the quarterly trends. Yes, lifting and refining declined, and EBITDA slipped. But we should note (I will say more about this later) that the 10% decline in EBITDA was largely due to the state of the market. We managed to compensate for all the negative factors, which I have mentioned. More on that later. And net income grew by 17.6%, helped, of course, by exchange rates and by growth of net income in our joint ventures.

I will pass you over now to my colleague from upstream, Alexander Mikheev.

Alexander Mikheev, Head of Economics and Investment (Upstream)

Good evening, colleagues, ladies and gentlemen. Allow me to present the operating results of our Upstream Division in the first quarter.

The first thing to point out is that we are still the leaders as regards hydrocarbon production trends. As already mentioned, production in the first quarter of 2017 was 22 million tonnes of oil equivalent, which is 4.8% more than in the first quarter of 2016. That growth reflects a substantial increase of production in our new projects. The share of new projects in total production rose from 4% in the first quarter of 2016 to 10% in the first quarter of 2017. This growth has levelled out. Comparison of results for the first quarter of 2017 with those for the fourth quarter shows a slight deterioration, which was due to the unfavourable weather conditions in the first quarter of this year: there were extreme negative temperatures in regions of Western Siberia, which meant that work had to be suspended at wells and made it hard for tankers to travel in the severe ice conditions at Novoport. On the right of the slide, we have factor analysis of change in the first quarter of 2017 compared to the first quarter of 2016. The main drivers of production were Novoport, Prirazlomnaya and Messoyakha. I already mentioned the negative trend at mature assets, and there was a minor contribution from our foreign assets and from Northgas and Arcticgas.

The production trend impacted development of operating costs, which is shown on the next slide. You can see here that our unit operating costs in the first quarter in absolute terms were 1682 rubles per tonne of oil equivalent. There was a positive trend in unit operating costs at international assets and new fields, mainly due to production trends at those assets, but there was very little impact from our mature assets and joint operations, and we can see growth of operating costs as a result of worsening quality of reserves at our mature assets, particularly in the Noyabrsk region and at Gazpromneft-Khantos.

I will say a few words about significant events that occurred in our new projects, looking at each of the projects separately (this is the next slide). We drilled and commissioned the first branched horizontal well in the Prirazlomnaya project. It was drilled in the first quarter using Fishbone technology. In our Iraqi projects, we drilled three production wells as part of the Badra project and successfully carried out an acid treatment operation at a well in Kurdistan. At Novoport we drilled two wells with dual (isolated) boreholes, which are unique in that region, and set a record for drilling speed (4.25 days for 1000 meters). At Messoyakha we had excellent results from a multilateral well, which produced more than 200 tonnes per day at launch. This will have major impact on the further development of our Messoyakha assets.

That's everything I had to say. I'll hand over to my colleague Vladimir Konstantinov.

Vladimir Konstantinov, Head of Economics and Investment (Downstream)

Good afternoon, colleagues. The first thing I should say is that the operating environment for downstream in the first quarter of 2017 was quite challenging, due to both external and internal factors. The external factors were changes in tax legislation (the last year of amendments to the tax system). The coefficient in the formula for calculating duty on crude oil fell to 30%, which tended to make crude oil more expensive for refining purposes. There was a 100% duty on fuel oil and further growth of excises on diesel fuel and medium distillates. Impact from these macroeconomic factors was intensified by repair work on an unprecedented scale in the first quarter – we have never seen anything like it in the history of the Company. All this inevitably made its mark on financial result in downstream, but we think that the result is quite good considering the



adverse conditions. We had positive margin in refining (about two dollars per barrel) and our sales business also worked efficiently.

I will say something about the crude oil balance and main changes to it. You can see that the biggest changes were in oil exports, which grew by 78% compared with the first quarter of 2016. There are two main factors at work: the first is growth of output and sales of Arctic oil, and the second is reduction of refining volumes. As regards exports to the CIS countries, there was a slight decrease in absolute terms. The decrease seems large in percentage terms, but in reality it was only about 100,000 tonnes, due to schedules in Belarus. Crude oil deliveries to the domestic market stayed at roughly the same level as in the first quarter of 2016.

The next few slides deal with refining. It was down 14% compared with the first quarter of 2016, including a 45% decline at the Moscow Refinery, 8% for YANOS and 1.9% for Omsk. I will go into more detail later as regards Moscow and YANOS. The slight decline at Omsk reflects optimization of volumes: we followed the logic of efficient refining volumes to obtain the best possible financial result.

Next slide. We haven't had slides dealing with repairs in previous reports, but they had special importance in the past quarter, not just as repairs, but also as regards our future capacities, so we wanted to talk about them in more detail. The repair work was also reconstruction work – particularly at the Moscow Refinery, where reconstruction of crude distillation unit (AVT-6) will boost energy efficiency and reduce fuel consumption in primary refining, and reconstruction of the G-43-107 catalytic cracker will increase light product yield by 353,000 tonnes annually (by our calculations), including increase of petrol production by 170,000 tonnes. There was also a lot of repair work at YANOS, both on crude distillation unit (AVT-4) and on the main 1A-1M catalytic cracking unit.

The next slide is about the Omsk Refinery, where there were no major repairs in the first quarter, and that can be seen in the level of production of high-margin products: output of high-octane petrol increased by 11%. We increased output of 95 and 98 petrol very rapidly, partly to meet needs of the sales network in the Central Region, compensating the effect of large-scale repairs at the Moscow Refinery. Output of diesel rose by 2% despite reduction of refining volumes by 2%, which is evidence of an overall increase in efficiency at the Omsk Refinery.

The next slide deals with motor fuel sales on the Russian market. We traditionally outperform in this segment. The overall retail market for petrol expanded by 0.5%, and our sales increased by 6.4%. The respective figures for diesel fuel are 1.9% and 13.7%. The number of our filling stations grew modestly, by just 2%, so most of the volume increase was due to increase in average sales per station, which were up by 5.9%. Our special programmes for motor fuel sales played a big role in boosting efficiency and increasing the volume of premium sales. Our "We are going the same way" loyalty programme is ongoing and we had about 8 million customers in the programme by the end of the first quarter. Successful advertising campaigns also had major impact on results.

As for non-motor fuels (the next slide), we increased the level of our premium sales in all segments except for bunkering. The sales increase for aviation fuel was 2.4% and we are expanding our presence at airports as well as taking an active part in international forums, where we present our products. For lubricants we even achieved double-digit growth in premium sales volumes thanks to expansion of the network of G-Energy service stations as well as steady growth of our import substitution programmes in the regions. There was quite substantial growth for bitumen (by 2.4 times). Of course, the figures in that segment are not as big as in other business units but I would note that the margin on premium products is quite high and growth by more than two times points to a major increase in efficiency. Bunkering is the only major product line, where volumes fell. There were two main factors at work here. The first is shrinkage of our bunkering operations in the Far East (I should say that we don't have enterprises producing bunker fuel in the Far East and Eastern Siberia, so we don't have competitive advantages in Far East markets), and the second factor is weather conditions in the Black Sea, which also led to some reduction in bunkering volumes. However, we increased sales on markets where we have competitive advantages and where operating conditions were favourable, particularly in the North-West, where we increased sales of bunker fuel by 21,000 tonnes.

So I would say again that, overall, results in downstream were good, despite the difficult environment. Thank you.

Alexey Yankevich, Chief Financial Officer

Ladies and gentlemen, let's move on now to financial results. As I have already said, the year-on-year trend was extremely positive. I won't need to make that point again.

Looking at quarter-on-quarter trends, it is interesting to note on this graph that EBITDA in the first quarter was worse than in the fourth quarter if we include one-off factors (repairs alone were about 5 billion rubles). Leaving out one-off factors, the trend was consistently positive: if there were no repairs, the first quarter would definitely be better than the third quarter, and generally, as the factors were one-off, we can take it for granted in future forecasts that the trend from the first to the second and third quarters will be upwards – the second quarter will surely be better than the first. And we expect that the year-on-year results in each quarter will also be positive.

A little more detail about year-on-year factor analysis. There isn't a lot to comment on, really. The external environment certainly improved compared with last year: prices recovered, and that made a difference. You can see too how big the contribution was from our upstream projects: successful implementation of these projects was worth 20 billion rubles, which is a lot. But we also had the one-off factor of repairs – minus 10 billion.

Quarterly trends are probably of more interest to analysts. I repeat that, despite a number of one-off negative factors that were specific to us – firstly repairs and secondly weather conditions that affected production – we managed to more than compensate the production loss by various measures to reduce expenses and costs (you can see the cost reductions in our reporting). So, overall, internal factors are even positive: plus three billion. It may come as a surprise (it was a surprise for us when we looked at it), but for us, as a vertically integrated company, strangely enough, the first quarter was worse than the fourth quarter in terms of the external environment, even though world prices rose. This was due to two factors. Firstly, there was a reduction in refining margin, which often happens when crude prices are on the rise (the cracking spread can fall, and that is exactly what happened), so that the theoretical margin for any refinery in the world decreased; prices for petroleum products could not keep up with prices for crude, and this affected refining margin. There was also an effect from change in excises, but that was a more specifically Russian factor. These two factors together led to a decline of refining margins. That is the first thing. The second thing was strengthening of the ruble. You know about the situation with the ruble at the start of the year, and I won't comment on it, but, naturally, ruble recovery is a negative factor for exporting companies. These factors together produced a substantial minus effect of 17 billion, and that accounts for the trend. So a good showing in the first quarter compared with the fourth was more a matter of "who fell less" than "who grew more". When other companies publish their results we will probably see roughly similar trends for the first quarter against the fourth.

As for cash flows, we are doing our best not to disappoint you – analysts and investors. We promised that we would have positive free cash flow this year and, despite a difficult quarter overall, we achieved zero free cash flow. We hope to consolidate the positive trend in coming quarters, thanks to improvement of financial performance and cash flows. Certainly, some of the effect came from lower investments, which are traditional in the first quarter, but slightly worse results are also usual as a seasonal effect in the first quarter. One thing compensates the other. Of course, we should expect a large amount of capex in coming quarters, but we also expect bigger cash flow, which is to say that cash flows will continue to balance out.

The next slide shows capex trends. We see that capex is down compared with last year, and that is because major investments for the launch of large new fields (such as Novoport and Messoyakha) were completed last year. That effect is in the past and investments in greenfields have declined. The explanation of the decrease for brownfields isn't so obvious: it is connected with weather conditions, which Alexander Mikheev talked about – extreme low temperatures made it very difficult to carry out all sorts of work, including work of a capital nature and well workovers. I would also call attention to the growth of investments in refining. This is logical, we have been saying for a long time that implementation of the next stage of refinery modernization is getting underway. We have two big projects in the offing: at the Moscow and Omsk refineries (Moscow is slightly ahead, with its Euro + project, and Omsk is coming along behind). We actually have an increase, as the project is entering the active phase. Marketing costs have risen, but they are not very great, they occur as a function of change in the project implementation schedules. We implemented a few more projects during the first quarter than last year.

To conclude let me talk about liquidity and the loan portfolio. The portfolio and overall liquidity have not changed much, but there has been an improvement in the net debt to EBITDA indicator: you can see in the reporting that it is on the decline and has already fallen below 1.5x. I think that this is a very good level: it is



the threshold value, which we set as a target before the crisis, and the fact that we have reached a level under 1.5x in the current difficult conditions of much lower prices than before 2013 is very positive in itself. The rating agencies also take a positive view. Our ratings may not have changed yet, but the outlook has changed. Obviously, the sovereign credit rating of the Russian Federation sets natural limits, but, in general, within these restrictions, Moody's has revised our outlook from negative to stable and Standard & Poor's improved the outlook from stable to positive. These are signs that, in the future, we can hopefully look forward to an improvement in the ratings themselves. Finally, we continue to close successful debt transactions: in April we placed ruble bonds very successfully, with 5-year maturity and a coupon of 8.7%, which is the lowest coupon of any corporate issue since 2013.

That concludes the presentation. I emphasize once more that the first quarter was not easy, but, nevertheless, the trend from last year is very good. There are certain one-off effects, but they will disappear in coming quarters. We expect further positive trends and hope to have good news for you in the coming quarters. Thanks for listening. We are ready to answer questions.

Q&A

Question №1

Andrey Polishchuk, Raiffeisenbank

Good afternoon! Andrey Polishchuk, Raiffeisenbank. Thanks for the chance to ask a question.

I have two questions. The first is about upstream: you mentioned that initial debit at the Messoyakh group had increased and this will affect the development plan. Can you say in more detail how this will affect development. And the second question: did I understand correctly that you are planning to show positive free cash flow in 2017, and how will you do that? As far as I can remember, capital investments for 2017 were planned at the level of 2016, and, as I see it, positive cash flow in 2017 in the first quarter was mainly due to reduction of capex. Thank you.

Alexey Yankevich, Chief Financial Officer

I will ask Alexander Mikheev to respond to the first part of the question, and then I will answer the second part.

Alexander Mikheev, Head of Economics and Investment (Upstream)

Thanks for the question, Andrey. As regards this well, firstly, it is unlikely to change the development plan, which is currently approved by the company for the Messoyakha asset group. But we are now studying the results from drilling of this well, which could lead to a change in our forecasts for production from the Messoyakha assets. That's the first thing. Secondly, we used multiple-borehole technology at this well and we are looking at the results from a technological point of view. And finally: this is still just one well, and we are drilling more than 100 wells a year at Messoyakha, so we won't understand what the long-term production profile will look like and whether or not the development system will be adjusted in the future until we have studied the results and piloted wells of a similar kind and with similar design.

Alexey Yankevich, Chief Financial Officer

As for the second part of the question, regarding cash flow, I say again that our goal is to achieve positive free cash flow. How will we do this? Primarily, by improving cash flow from operations. This will happen, firstly, because we will increase production and the lag at Novoport is being compensated (through efficient production). So production as a whole will grow, compensating for the lag in the first quarter. And secondly, as you can see from the reporting, there was a one-off effect: worsening of working capital took things in the opposite direction compared with last year. This always happens with growth of oil prices: the price of oil has increased and when the price grows, working capital always increases. Taxes and refunds of VAT come along behind that – it's all part of the same thing. So this is a one-off effect, which will also go away. Plus, also, we have specific plans to optimize working capital, which I'll tell you about later. And we have certain tools to improve our cash flows, which I will do better to tell you about in the second quarter, when there are definite results. To sum up: capex will grow, but cash flow from operations will also grow.

Andrey Polishchuk, Raiffeisenbank

Thank you very much. A small clarification, if you don't mind: did I understand correctly that the plan for capital investments remains the same, 380 billion rubles?

Alexey Yankevich, Chief Financial Officer

The plan for capex remains the same. The amount may change a little, because there is a foreign currency component, which depends on exchange rates. If the ruble is strong, then theoretically the amount could be less. So I can't name the exact amount, but the size of the investment programme relative to the size of projects will remain the same.

Question №2**Alexander Kornilov, Aton**

Good afternoon, and thanks very much for the chance to ask a question.

I actually have two questions. The first question is: in the context of current discussions about a nine-month extension of the agreement to reduce production, starting from the first of July this year, have you thought about your options for reducing production? In other words, can the extension of this agreement somehow affect your plans for key greenfields (Messoyakha, Novoport, Prirazlomnaya)?

And the second question. You mentioned during the call that your refining margin in the first quarter was USD 2 per barrel. Could you share information about how much the margin increased in April and May, respectively, taking account of completion of repair work at the Moscow Refinery? Thank you!

Alexey Yankevich, Chief Financial Officer

Alexander, thanks for the questions. As regards OPEC, yes, indeed, the agreement will affect our production to some extent, but we will certainly try to fit into these restrictions in such a way that production is reduced in projects that are less efficient than our greenfields and we have may ways of doing that. We have wells with higher water cut, fields with worse economics than greenfields. So greenfields will not suffer. I can say that the plan, which we have announced for Novoport and Messoyakha, will definitely be implemented. Most probably, the reduction will affect brownfields and fields that are at the bottom end in terms of economics. That is the logical decision. I would emphasize that we intend to implement our stated target (89.2 million tonnes of oil equivalent) even taking account of these limitations.

The second part of the question was about refining margin. Yes, indeed, refining margin has improved. It is above the USD 2 per barrel, which you mentioned. I won't state an exact figure now, because it is changing. But margin will definitely be higher.

Alexander Kornilov, Aton

Thank you very much! Can I ask one follow-up question? You said that the plans for Novoport and Messoyakha will definitely be implemented, but you didn't say anything about the Prirazlomnoye field. Does this mean that plans for Prirazlomnoye might change somehow? Thank you!

Alexey Yankevich, Chief Financial Officer

The plan for the Prirazlomnoye field also remains unchanged. There has been a scheduled stoppage, but it was planned a year ago. So, taking account of that, the declared plan will be carried out.

Question №3**Olga Danilenko, Prosperity**

Hello, thank you very much for the presentation and for the opportunity to ask questions. My question concerns dividends. Last year, you decided not to pay semi-annual dividends, but to pay full-year dividends. Can you tell me, please, what you are planning to do this year? Thank you!

Alexey Yankevich, Chief Financial Officer

Olga, thanks for the question. We haven't made a final decision yet, we are still in the early part of the year. But I can say that our main task is to increase dividends per share. Dividends per share this year were significantly higher than what we announced for 2015. We are expecting our next dividends per share will also

be higher. So we are primarily oriented to a positive trend in dividends per share and dividend yield. As for the payment schedule – we will get to that. For the moment we are still at the beginning of the year; no decision has been made yet.

Question №4

Ekaterina Rodina, VTB Capital

Hello, could I clarify: there were a lot of reports last week about emissions at the Moscow Refinery. What is the status of repair work now, has reconstruction of the catcracker been completed already? Is work still going on – pre-commissioning, test operation – or is it all up and running as it should be? Thank you!

Alexey Yankevich, Chief Financial Officer

Ekaterina, thanks for the question. I can tell you definitely that the Moscow Refinery has completed its scheduled repairs, all the work has been completed and the Refinery is operating in standard mode in accordance with the production schedule and planned operating regimes. And I would point out, since you mentioned the environment, that inspections have shown the absence of hydrogen sulphide in emissions from Refinery installations.

Question №5

Pavel Kushnir, Deutsche Bank

Good afternoon, thank you very much. My question is about the investment plan for 2017. You repeated the figure of 380 billion rubles, but simple calculations suggest that average quarterly capital investments in the second, third and fourth quarters will have to be 60% higher than in the first quarter in order to achieve that amount. In previous years, the growth was only 20%. Obviously, the base effect is substantial here. But, for better understanding of how you are going to spend such large investments, maybe you could give a capital investment forecast for each of the segments: brownfields, greenfields and refining? Or give a more realistic forecast. Thank you.

Alexey Yankevich, Chief Financial Officer

Pavel, thank you for the question! Look, the slight mismatch you have in the figures is probably because you are looking at the figure of 380. We had it in the press release following the meeting of the board of directors, since it is the official figure for our investments, but it is calculated based on completion. Which is to say that it is the volume of equipment brought into operation and the lead times for that equipment. But we, as finance people, are interested in the amount of financing, of money, and what you see in the statements is precisely investment cash flow. If we take the investment cash flow, it will be less than 380. I won't give you an exact figure now, but it is probably at least 30-40 billion less than the completion figure. We will try to give you a more accurate figure later. Our plans change, partly due to the various financing instruments that we try out and use, including project financing. In other words, investment cash flow is likely to be less. This is actually confirmed by the figures you see in the statements: you can already see the cash flow now for the first quarter. The difference in financing of capex implementation arises because we made a lot of advances last year, particularly with regard to major projects, and we are implementing this year the volumes that we factually financed last year.

Pavel Kushnir, Deutsche Bank

Thank you. Investment cash flow is what interests us too.

Question №6

Evgeny Dyshlyuk, Gazprombank

Good afternoon, thanks for the chance to ask a question. I have a follow-up question about production under the agreement between Russia and OPEC. Production fell by 4% against the level in the fourth quarter, so my question is: how much of that decline, what percentage relates to the OPEC agreement and how much of it relates to weather conditions?



And a second question. If the agreement is extended, could you give a forecast of the Company's oil production this year? Initially, we expected growth of about 6-7%. So what will the figure be if this happens? And, if possible, could you give a breakdown of the figures by consolidated production units. Thank you.

Alexey Yankevich, Chief Financial Officer

Evgeny, thank you for your questions. As to first question about the production trend in the first quarter against the fourth, the greater part of it was due to weather.

As for the second part of your question about forecasts, let me emphasize again what I already said, that the overall target of 89.2 million tonnes of hydrocarbons will be fulfilled, since this already takes account of the limitations. As for oil production, we expect growth of at least 3% this year in any case.

Anna Sidorkina, Head of Investor Relations

Colleagues, thank you very much for taking part in our conference call. Thank you for your questions. If you have any further questions, we are always happy to discuss them with you. And thanks also to our management for the excellent presentation and detailed answers. Best wishes, until the next quarter.