

Gazprom Neft PJSC**Financial and Operating Results in Q2 2018****16 August 2018****Anna Sidorkina, Head of Investor Relations**

Good afternoon, ladies and gentlemen, this is Anna Sidorkina, Investor Relations.

Allow me to open this conference call to present the Company's financial results for the first half of 2018 and to introduce the participants of today's conference call. As usual Alexey Yankevich, CFO and member of the Management Board, will comment on our financial reporting. Alexey Urusov, Head of Economics and Investment Directory, will tell you about the upstream business, and then Vladimir Konstantinov, Head of Economics and Investment in the Downstream Division, will talk about downstream events. For the Q&A session we will be joined by colleagues from relevant departments, who will be glad to answer your questions.

As always, before we start our conference call I would like to remind you that the presentation you see on the webcast on our site, and comments made during the presentation, may contain and will contain forward-looking statements relating to the company's financial position and the results of its business activities. All statements, other than assertions about past facts, are or should be treated as forward-looking statements. Such statements express expectations about the future based on the current situation and assumptions made by Company managers, and involve both known and unknown risks and uncertainties that may cause actual results to differ materially from those contained in or implied by the conference call today.

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

Alexey Yankevich, Member of the Management Board and CFO

Greetings, ladies and gentlemen and welcome to this presentation of the business results of Gazprom Neft in the first half of the year.

We can confidently say that the results are very good. As you can see, indicators grew at record rates. Operating income rose by 50 percent and net income was up by nearly 50 percent. Of course, improvement of the macro environment for the oil industry in the first half of 2018 contributed to the growth of financial results. Oil prices rose and the ruble weakened. But internal factors also played a major role – growth of production, restoration of refining volumes after maintenance in the first half of last year, and gains in refining efficiency thanks to the maintenance. You will also see that production of light petroleum products has grown very fast – by almost three percentage points, which is a lot for this indicator. Sales through premium channels grew, retail sales increased. We have worked hard to improve upstream efficiency in the face of OPEC+ quotas: per unit lifting costs fell, despite inflationary pressure. Our efforts, combined with volume growth, have maximized financial performance.

The quarterly trend is also positive: revenue increased, as did operating and net income. The effect of the external environment was enhanced by internal factors, of which I will say more later – they included increase of production, greater refining efficiency and growth of premium sales.

That's all I wanted to say by way of introduction so I will hand over to my colleagues. As usual, we will start with upstream.

Alexey Urusov, Head of Economics and Investment Directory

Good afternoon, ladies and gentlemen,

I would like to draw your attention to Slide 6, which shows development of the resource base in the first half of 2018. Our company is continuing to develop its resource base, and three things are worth focusing on. In April 2018, we acquired exploration rights at two areas on the Yamal Peninsula – Yuzhno-Novoportovskiy and Suroviy. The areas have no reserves on the state balance sheet and we are working to add reserves that can load production and transport infrastructure in this region. The second thing I would emphasize is that we obtained licenses in 2018 for areas in the Karabashkiy Zone. We now have subsoil

exploration and production rights there, so we will be able to carry out a program of geological study (very little study has been carried out at these areas in the past). And, finally, I would draw attention to our new oil production cluster in Orenburg. You will remember that we discovered the Novozarinskoye field in 2017. In 2018, we obtained a license for this field. There are geological reserves in excess of 11 million tons. You will also remember that we discovered the Novosamarskoye field with geological reserves of 8 million tons in the same region in 2016. We believe that this new oil production cluster in Orenburg can be a new point of growth.

Slide 7 shows how we are optimizing production in connection with the OPEC + agreement, and you can see that our growth rates are quite modest at about 3 percent. Our flagship Novoport project made the biggest contribution – 1.9 million tons – to y-o-y production growth in the half-year, along with the Messoyakha project which gave growth of 0.3 million tons. Our Iraqi projects and Arcticgas also met their targets for production increase.

Slide 8 shows a mixed trend for costs. On the one hand, we see economies of scale for large projects, where increase in production reduced unit costs and had positive impact on project economics. We were forced to close wells with high-water cut at mature fields, which also led to a reduction of unit costs. But unit costs rose at joint ventures due to reduction of output caused by the OPEC+ caps.

Slide 9 shows how we are building an icebreaker fleet, which we need to ensure uninterrupted transportation of oil from the Novoport field. In the third quarter, we commissioned a high-tech, new generation icebreaker, and we expect to have two modern icebreakers in operation by the end of 2018. Together with the six tankers, which we already have, this adds up to an integrated logistics infrastructure enabling uninterrupted transportation of oil from our northern fields.

And the last upstream slide shows our new assets near existing fields. There are two points of growth here. The first is Yamburg (Achimov oil deposits), Severo-Samburg (Achimov oil deposits), Tazovsky and the Peszovoye fields. We are carrying out intensive geological studies at all four of these locations. We have had successful results from new well tests, well workovers have been carried out, and we have successfully tested of high-debit wells at Severo-Samburg (impressive production rates of 193 and 35 tons per day). We also plan to drill new wells at these fields with multi-stage hydrofracturing and to carry out additional geophysical studies so that we can confirm volumes and prepare a development plan for these fields. We carried out seismic exploration at the Zapadno-Zimneye field in Western Siberia, which is less remote than Yamburg. We have also completed three wells, which we are preparing to test, and the Central Commission for Field Development at Rosnedra has approved our pilot production plan.

So, overall, we are developing new production assets and building a solid base for the future.

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

Good afternoon, ladies and gentlemen. I said at our previous meeting that the first quarter of 2018 was extremely tough for refining business. Oil prices rose and the exchange rate trend could not compensate for the higher prices. So the cost of crude oil inputs for oil refining increased significantly. Prices on the domestic market were relatively stable. As a result, refining margin in the first quarter was unusually low at about one dollar per barrel. The second quarter was much better for oil refining – the business improved and we had quite a good result for the first half of the year as a whole. Average refining margin at all Company refineries in the second quarter was above three dollars per barrel. The figure was positive at nearly all our refineries. Financial results in refining business for first six months were quite good.

As regards the crude oil balance, our total crude oil resources in the first half of 2018 were comparable with the first half of 2017 (there was a small difference of about 300,000 tons). But there were major changes in the structure of the balance, mainly to do with changing market trends and large-scale overhauls at our refineries. Refining volume grew by 1.8 million tons compared with the first half of 2017. We had no major maintenance like those last year. Our crude oil exports were down by 1.3 million tons and we supplied less crude to the domestic market. It was harder to make efficient purchases and our sales of crude on the domestic market fell as a result.

The next slide shows volumes and performance at our refineries. As I said, the throughput grew by almost 10 percent compared with the first half of 2017 and there was growth at all refineries. The biggest growth was at the Moscow refinery, where the scale of maintenance was much reduced in comparison with a year ago. Growth there was almost 37 percent. Refining increases at the Omsk refinery and YANOS were due to our work on performance improvement. Overall growth reflects the fact that refining was more efficient than crude oil exports.

Looking now at refining depth and light petroleum products yield, Alexey Yankevich already mentioned improvement of these indicators. It was due to a reduced repair schedule and the impact of maintenance works carried out in previous periods. We optimized the structure of petroleum product outputs. We produced large quantities of marine fuel at the Omsk refinery instead of fuel oil. We increased production of bitumen at the Omsk and Moscow refineries. The result for light petroleum products yield is mainly due to the optimization of process technology.

There is quite a lot to say about the next slide. We have a major event coming up this year and at the start of next year, when we will commission the first large installation from our pool of new oil refining installations. This will be a EURO+ complex oil refining installation, which will replace several previous-generation units (including CDU, a reformer and an auxiliary production unit that serves the main production processes). We believe that the new installation will make production processes more energy-efficient. It will also lengthen operating periods between repairs from two years to four years. Construction work on the new installation is already 90 percent complete. We have assembled the equipment, connected it to the pipeline system at the refinery, and we are now carrying out hydrostatic tests. The installation should be ready for launch in the fourth quarter of 2018.

Turning now to factors and results in the marketing segment, our retail sales are growing faster than the market. Total retail sales of gasoline and diesel fuel in Russia in the first half of the year increased by 1.4 percent, while the figure for Gazprom Neft was about 5 percent. Efficiency improvements made a big contribution to the growth of retail sales: average daily throughput per filling station reached 20 tons.

Nearly all of our other marketing units – aviation fuel, bunkering, lubricants and bitumen – showed strong growth compared with the first half of 2017. The growth for aviation fuel was over 10 percent and the figure for bitumen was 30 percent. Bunkering and lubricants were not so strong. In lubricants, we are working to improve the production structure and raise the share of high-margin products in total sales.

The last thing I would like to tell you about is our new, efficient, high-tech asset in the city of Salsk in Rostov Oblast. We bought it as part of work to develop our bitumen business. It has annual capacity of 25,000 tons of high-margin bitumen, complementing our range of premium products and raising our premium bitumen capacity to 300,000 tons.

Thank you.

Alexey Yankevich, Member of the Management Board and CFO

Dear colleagues, let's go back to our financial results analysis. As I already mentioned, our operating and net income grew, both year-on-year and quarter-on-quarter. Let's look at this on a slide with factor analysis. It was the result of factors to do with the Company itself – growth of business scale and increase in efficiency – and not just the result of price growth and weakening of the ruble. Factors specific to the Company contributed about 30 billion rubles in the first half of the year, and about half of that came from upstream. The main things were production increases in new projects and measures to improve efficiency and reduce costs at mature fields. The other half (the contribution from downstream) came from gains in refining efficiency and growth of premium and retail sales.

The quarterly trend was also due to specific business factors – production growth, improvement of refining efficiency, and growth of premium and retail sales – and not just to external factors. Downstream played a bigger role in the quarterly trend.

Let me say something about free cash flow. I am pleased to tell you that the Company has achieved steady positive free cash flow. Free cash flow has grown significantly compared to last year. It is not just positive – it is more than 70 percent bigger than last year. In the first half of the year, if you look at the statements and strictly follow IFRS, free cash flow was RUB 48 billion. If we add free cash flow in the Messoyakha project, where our share was RUB 8 billion (we receive this money as repayment of loans previously issued), free cash flow – in principle, in management accounting terms – was about RUB 56 billion. There is also cash flow from the Messoyakha project related to substitution of our investments by a project loan; it is in the "Other" section in the amount of RUB 26 billion, but it is not quite correct to view it as free cash flow, because it is related to borrowing for a joint venture. But if we take generation of free cash flows as such, then, taking account of our joint projects, the amount is about RUB 56 billion, which means that we can significantly increase the amount of dividend payments without increasing debt, which, I think, you and will see happening for 2018 results. We also reduced debt: net borrowings were minus RUB 59 billion. We paid interim dividends of RUB 47 billion for nine months and we plan to pay the remainder in the second half of the year.

Investments grew by 2.5 percent year-on-year. Our forecast remains the same overall: we expect the investment trend to be steady. 2.5 percent is not much, but that is due to distribution between quarters and six-month periods. The growth mainly reflects investments in refining when talking about the dynamics within the segments. We are in the intensive phase of our modernization program. We have planned a certain shift from upstream to downstream in 2019-2022 due to more intensive modernization. Investments in upstream have been reduced, as we have said, and that applied to both greenfield and brownfield. There were inflationary factors, which tended to push investments up, but reduction of the scale of operations led to reduction of investments in upstream.

The substantial growth of financial results greatly improved our financial stability. We approached the psychologically important figure of one-to-one for debt-to-EBITDA. This is a low figure and it shows that, as well as generating positive free cash flow, we also have capacity for additional borrowing, which we could take advantage of if necessary. Our financial stability gives us that option. We clearly have scope for borrowing, because the one-to-one ratio is not really a target – it's a figure at the bottom end of our comfort range.

The repayment profile is also quite comfortable. The main volume is 3-5 and more than 5 years into the future. So there is absolute confidence that we will meet all of our short-term obligations.

One important event of the half-year was the placement of bonds in the first half of the six-months and repayment of our second Eurobond issue. That was the issue of Eurobonds at 2.933 percent per annum, which we settled in April 2018. So we still have two dollar issues outstanding.

That's everything I wanted to say. I would emphasize again that all our projects, all our plans are going ahead in line with the expectations that we already outlined to you. The company is developing. Certainly, we have been held back by the OPEC+ agreement as regards upstream growth. But the revision of the agreement gives us an opportunity for additional production. If you look at our daily production volumes, you will see that they have increased quite quickly and substantially; we take full advantage of the opportunities that this agreement gives us, so I expect a better production trend. In downstream, we place great hopes on launch of the EURO+ project, which, I think, will happen on time. It will give a major increase of refining margin at the Moscow refinery and put the refinery in a strong position in the conditions, in which the segment is currently operating.

Thanks very much for your attention. I am ready to answer questions.

Q&A session

Question №1

Alexander Burgansky, Renaissance Capital

Hello. Thank you very much for the presentation and for the opportunity to ask a question.

First question. You spoke of an increase in dividend payments for 2018. Do you plan to pay interim dividends? And is there any guidance on the payout ratio?

The second question is about taxation at the Novoportovskoye field starting from 2019. You said earlier that you plan to transfer it to the excess-profit tax regime. Is there any guidance on how this will change the taxation level at Novoportovskoye field? Thank you.

Alexey Yankevich, Member of the Management Board and CFO

Alexander, thank you very much for the questions.

As regards dividends, I confirm that we will continue the practice of paying interim dividends, as we did last year. We will declare interim dividends for the first nine months, as we did then. As for the payout ratio, I think we will announce that a little later, closer to the time when we make a decision on interim dividends for nine months. But there is a clear intention to increase this payout ratio compared with what you saw in the last dividends.

Answering the second question, about Novoportovskoe field, I would reaffirm our intention to include it in the excess-profit tax regime: so that project will be operating under a new tax system from 2019. I won't give you the numbers; we can send a report afterwards. This is a new system, so there are parameters, parameters for Novoportovskoe field, and you could do the estimates yourself if you wanted, but we can send them separately for your convenience. I won't give a precise figure now, because it consists of several

parameters – to do with cash flows and the overall economics of the project. But these parameters certainly won't be worse than under the existing tax system.

Question №2

Andrey Polishchuk, Raiffeisen Bank

Good afternoon, thank you for the opportunity to ask a question. I have two questions.

The first is about reporting. You have a dramatic increase of working capital in the first half of 2018, and the negative effect was more than USD 500 million. What should we expect in the second half of the year? Should we expect a similar increase in working capital or might we see the reverse effect?

And the second question. I would like to know you will do with the free cash flow, given that it is growing rapidly. You don't plan to increase capital investments, so should we expect the free cash flow to be almost entirely or mostly distributed to shareholders, or will you use it to repay the debt, which doesn't seem to be a priority, since your debt load at the moment is low. Can you please explain. Thank you.

Alexey Yankevich, Member of the Management Board and CFO

Andrey, thanks for the questions.

You are right that working capital has grown, it has grown by about 30 billion and that is perfectly logical. It was bound to happen, because whenever prices rise, and prices rose in rubles due to two factors – firstly, oil prices in dollars grew, and, secondly, the ruble weakened. Usually these factors work in opposite directions, but here they compounded each other. Oil prices grew and the exchange rate weakened. Naturally, the ruble value of debt, of accounts receivable, inventories, has grown substantially. So, of course, working capital couldn't fail to grow. If you look at the reporting of other companies, which has already been published, you will see roughly the same proportional increase of working capital. All this is logical, it's an industry trend.

The second half of the year definitely won't be the same, because it is unlikely that ruble prices at the end of the second half will be substantially higher than at the end of the first half. So probably, more or less, you can expect much slower growth of working capital in the second half of 2018, or the trend will be flat. Plus, also, we had various small, one-off factors driving growth of working capital, which will be reversed in the second half of the year (about RUB10 billion).

My answer to the second question will be short. We don't plan to reduce our debt. It wouldn't make sense at present. One-to-one is the lower limit of our comfort range. So a ratio of net debt to EBITDA less than that isn't desirable. We see our comfort zone between one and one and a half, like we did before. So, as of today, we certainly have no reason to reduce debt.

We will try to use the money in the most optimal way. Dividends will undoubtedly, grow, as I said. That is one thing. On the other hand, it's a poor company that doesn't look for projects, but distributes all its money to shareholders. This would be wrong too. As one of the shareholders told me quite rightly, investing in a company isn't like buying a bond – it's buying a company that has prospects for growth. So, certainly, we will look at all the opportunities and if the market situation lets us earn more operating cash flow, we will look at the possibility of implementing additional projects. Probably, not so much this year as next year. It might be acceleration of our modernization program and some other projects in upstream, which will be more profitable than interest yield. We want to offer shareholders profitability much higher than 6-7 percent. So we will look for an optimal balance, but you can be sure that dividends will grow. We plan to increase dividend payout, and the net income, from which dividends are calculated, is growing. Certainly, therefore, you can expect a noticeable increase in dividends. Thank you.

Question №3

Justinas Paskevicius, Firebird Management

Hello. My question is about the current situation at the Lakhta Centre. How much has been invested in this project and what do you plan to do next?

Alexey Yankevich, Member of the Management Board and CFO

Thank you for asking. This isn't really our business project, so I won't go into the figures in detail now. I will only say that the project is going according to plan. Everything we have said still applies, so there isn't much to add. We expect the project to be completed at the end of this year.

Question №4**Evgenia Dyshlyuk, Gazprombank**

Good afternoon. Congratulations on the good results. I have a question about tax changes. Do you think we already have an approved version as regards excises, the coefficient, etc. Or are you and other companies still talking to the government about this, trying to optimize the arrangements for downstream? Thank you.

Alexey Yankevich, Member of the Management Board and CFO

Evgenia, thanks for the question. We think that the main parameters of the changes have been approved and they are optimal. We took an active part in discussion of the changes, together with other companies. We are still in dialogue about fine-tuning of excises, including the damping adjustment, which the tax changes provide for. There is still work to be done. It would be nice if the system was even better, so that it could start to address problems on the domestic market as soon as possible. Certainly, the situation we have now is complex. The domestic market can't cope with the pressure from growth of world prices, magnified by weakening of the ruble. The market just can't cope with such a degree of pressure, so, certainly, the tax changes have to take account of all these factors. That's what the damper adjustment is for. We are still discussing the details.

Evgenia Dyshlyuk, Gazprombank

Thank you. Can I ask one more small question? Do you think it would be possible to adjust this formula and the whole of the draft bill to achieve a mechanism that would avoid the quotas for the supply of oil or petroleum products to the domestic market, which are currently being discussed? I am thinking of prohibitive measures, that make companies either supply oil for refining or petroleum products to the domestic market. Do you think that the work being done could make it possible to do without these prohibitive measures?

Alexey Yankevich, Member of the Management Board and CFO

Thank you for asking. Yes, probably. Any system can be set up in a way that allows market mechanisms to function. We have always been in favour of market mechanisms. You may remember the comments of our Management Board Chairman, Alexander Dyukov, when he was asked a question, not about quotas, but about state regulation of prices. The position of our Company has always been that market mechanisms are the most optimal and that the market must self-regulate. I think that we can come round to this position. Of course, it's not easy. The first thing that always comes, what can be implemented most quickly, is administrative measures. They help in an extreme situation. But we believe that, in the medium term, market mechanisms should be found, and we are ready to take part in discussion of any market instruments.

Question №5**Olga Maryasova, Evli Bank**

Good afternoon. I wanted to ask about the cost of debt. What is the average-weighted rate on your debt at the moment? How has it changed since the start of the year?

Alexey Yankevich, Member of the Management Board and CFO

Thank you for asking. This is an open information, you can find it in our MD&A. Our average rate has grown from 5.54 in the last half-year to 5.99 in this half-year. But you need to understand that the growth is due to substitution of foreign currency debt by ruble debt. And it is not really appropriate to weigh and compare ruble and dollar rates, because, nominally, the formal rate in rubles may be higher, but, as you know, ruble inflation is higher than dollar inflation. So you have to compare the inflation adjustment rate. There are special curves that let you compare dollar and ruble rates in comparable conditions. They show that our rate is not increasing. If you take our ruble rate now and use the curves to translate it into dollars, the rate is no higher than we used to have in dollars. You will see further rate increases in nominal terms, because ruble borrowings are gradually replacing dollar borrowings. The ruble share continues to grow. But that shouldn't

worry us because it is a rate in rubles, where the higher nominal rate is partially compensated by the difference in inflation.

Olga Maryasova, Evli Bank

Can I ask a question about the balance sheet? You have a deferred income liability under long-term debts. It was about RUB113.3 billion at the end of the first half of this year. What is the best way of accounting for this item. Should it be treated as debt that will have to be paid or in some other way? What is your advice?

Alexey Yankevich, Member of the Management Board and CFO

Thank you for asking. It's not a question, which I can answer in a couple of words. You would need to study the Standard for income tax, which describes deferred income tax. But I will try to explain very quickly using an example. Firstly, this definitely isn't a debt, it's not a liability. This item usually arises when tax depreciation goes faster than required under IFRS. In effect, the government allows us to depreciate a number of assets more quickly. So in the initial period after the assets are commissioned you write off more of the value and pay less income tax. In the future, you will pay more because the value will have been depreciated, the depreciation will have ended and you can't present it for tax purposes any more. And because the accelerated depreciation will end in the future and, accordingly, the asset will be more profitable for tax purposes, it will pay slightly more income tax. The deferred income tax liability is to do with this. But, again, you can look at it in more detail.

Olga Maryasova, Evli Bank

Thank you very much.

Anna Sidorkina, Head of Investor Relations

This is Anna Sidorkina, Investor Relations. Olga, if you want, we can organize a conference call for you afterwards with our specialists on consolidation to discuss this in more detail. Let's talk on the phone after today's conference call and discuss it.

Alexey Yankevich, Member of the Management Board and CFO

The main thing to understand is that if this was one specific asset, then yes, formally, we would have some reserve, which would be the extra tax that we will pay in the future. We pay less now, because the government lets us to do accelerated depreciation, we reduce our income tax, and we will have to pay more in the future. Because the business is ongoing and new fixed assets are constantly being commissioned – drilling continues and so on – this effect is constantly shifted to the future. You can expect our tax payments to be stable. In theory, this reserve, will end when the company ceases to exist. The reserve will be used at that time. Until then, it will continue to be moved forward, because there will be new assets that allow us to use this accelerated depreciation.

Olga Maryasova, Evli Bank

Thanks, now I understand

Anna Sidorkina, Head of Investor Relations

Friends, colleagues, ladies and gentlemen, thank you very much for your interest in our Company. Many thanks once again to our management, who have given an excellent account of our business results in the first half of the year. If you have any remaining questions, we are happy to answer them separately. I look forward to the next conference call. Thank you and best wishes.