

**Financial Results in Q3 2016
24 November 2016**

Anna Sidorkina, Head of Investor Relations

Good afternoon, ladies and gentlemen. We are pleased to welcome you to our conference call dedicated to results in the third quarter of 2016. Alexey Yankevich, our CFO and Management Board member, will present and give comments on financial results. Alexander Mikheyev, who heads the Economics and Investment Department of our Upstream Division, will tell you about upstream business in the period. Vladimir Konstantinov, head of the Downstream Economics and Investment Department, will talk about the downstream business. We also have our colleagues from various departments who will help to answer questions on particular businesses in 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 conference call may and will contain forward-looking statements relating to the financial position and business results of Gazprom Neft. All statements, other than assertions about past facts, should be treated as forward-looking statements. Such statements express expectations about the future based on the current situation and assumptions made by Company managers, and involve known and unknown risks and uncertainties that may cause actual results, performance or events to differ materially from those, which are contained in or implied by the conference call today.

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

Alexey Yankevich, Chief Financial Officer

Good afternoon. Today we will be presenting financials for nine months of 2016. I'll say at once that it's a pleasure to do so, as the results were very pleasing. I hope you will like them too. The figures are really very impressive. Production rose strongly once again, by 8.1%, which must be one of the highest, if not the highest growth rate in the industry. So we have shown once again that we are a fast-growing company. Even more positively, the production growth was matched by a very good trend in our financials. EBITDA grew by 4% year-on-year and net income increased by almost 13%. At first glance, 4% may not seem much, but you have to remember the context in which this growth occurred – returns in the oil sector worldwide and in Russia fell significantly year-on-year. Oil prices year-on-year were down by 24%, and increase of the tax burden, recalculated for our EBITDA, was almost 7% due to change of tax rates and various one-off initiatives. So you can see that growth by 4% is a very good indicator, given the 7% increase of the tax burden and a significant decline of prices. Quarterly dynamics were very good too: sales increased and so did EBITDA. EBITDA rose by more than 13%, production was up by almost 4%, and sales volumes in our retail network reached a record level of 20 tonnes per day. These are very good figures. Some of the best in the industry.

Next let me say a few words about main events. There aren't many of them to describe, but they are very important for the Company, determining our future growth prospects. We launched the Messoyakha field, which was our second major oil field start-up this year. We have already talked about the Novoport field launch, and in the 3rd quarter we launched Messoyakha, which we did ahead of schedule and successfully – oil has already started flowing through the Transneft system, and we expect to have industrial production volumes from the field next year. Also the Shinginskaya gas-turbine station entered service as part of our major project for utilization of associated gas. And it is, of course, important to mention that our year-round oil export system from the Novoport field was tested for the first time this year. That's not specifically a 3rd quarter event, but it is a key achievement for the year overall. We are fully confident that we can logistically ship the scheduled amounts: everything works, and we are confident about planned volumes for next year. All the infrastructure that we need in order to achieve industrial volumes next year is ready today, so we are fully confident about our plans for next year. Things worthy of note in downstream, as well as start-up of the logistics scheme, are the acquisition of two new assets in the premium distribution segment and in special petroleum products: we acquired a bitumen plant from the company Nova-Brit, which makes advanced bitumens, as part of our overall strategy to move towards premium bitumen grades and high value-added bitumen products; and we acquired Rospolykhim, which is an asset at the top of the lubricant technology chain, which will mean that we can achieve new standards in lubricants, making products that we weren't able to make before – also products with high value-added.



I'll hand over now to my colleagues from Upstream and from Refining and Marketing. Starting with Alexander Mikheyev from Upstream.

Alexander Mikheyev, Head of Economics and Investment (Upstream)

Good evening, ladies and gentlemen. Allow me to present our results for the 3rd quarter of 2016 in the Upstream Division. We saw further steady growth of hydrocarbon production in the 3rd quarter. Average daily output of consolidated entities in the 3rd quarter of 2016 was 236 tonnes per day, which is almost 3% more in the 2nd quarter. Hydrocarbon production in absolute terms in the 3rd quarter was 21.7 million tonnes of oil equivalent. The strong 3rd quarter trend was mainly due to growth of hydrocarbon production at our major Novoport project, thanks to the launch there of new infrastructure in the 3rd quarter.

The next slide shows nine months and you can see that we grew by 8% compared with the same period of 2015. Again, the main contribution here for liquid hydrocarbon production was from Novoport and also from Prirazlomnoye, as well as our large-scale Badra and Arcticgas projects. The main factors for gas were commissioning of gas infrastructure facilities at the Yaro-Yakhinskoye field at Arcticgas, as well as increase of our ownership interest in Northgas.

Our upstream management remains focused on better control of operating costs at mature assets, as you can see from the next slide. Organic growth of unit operating costs at mature assets was 5.8%, which, as you know, is much lower than the current inflation rate.

Looking at implementation of our key large projects on the next slide, the Messoyakha project stands out again. The East-Messoyakha field was commissioned in September, after the construction of surface infrastructure was completed. A total of 51 wells were drilled, which are now in production. We expect this to be a very promising project with a production peak of 5.6 million tonnes of oil equivalent by 2020.

We are also continuing the construction and launch of key infrastructure facilities at Novoport. You can see this on the next slide. The main pipeline was brought into operation in June; the first part of the central gathering point with capacity of 5.5 million tonnes started work in August. Forecast production at Novoport this year is in excess of 2.5 million tonnes of hydrocarbons. As remarked before, this is helped by and smooth and efficient management of our tanker fleet to ensure logistics. There are currently six tankers at work.

Next slide. What we show here is our technology leadership. We remain focused on the introduction of new technologies and this slide shows new work for drilling of horizontal wells with multiple horizontal branches, using so-called, fishbone technology. The technology improves well productivity by increasing coverage of the oil-saturated reservoir sections. The picture on the left is a schematic diagram of a borehole. By using this technology we can greatly increase coverage of oil-saturated areas while carrying out less drilling work. The effect is to increase well flow rate by about 40% in comparison with similar horizontal wells drilled in the same areas of the formation.

That's about everything I had to say about Upstream, so I'll hand over to Vladimir Konstantinov.

Vladimir Konstantinov, Head of Economics and Investment (Downstream)

Good evening, ladies and gentlemen! Briefly about results of the Downstream Division of Gazprom Neft in the 3rd quarter and first nine months of 2016. Unlike the first two quarters the oil price was fairly stable in the 3rd quarter at \$45-46.6 per barrel. Refining margin was consistently above \$3 per barrel for the whole quarter at Gazprom Neft refineries in Russia. The Company's total resources grew in comparison with the same period in 2015, mainly due to increase of oil production at Arctic fields, and that was one of the causes of the increase in exports. The other reason for export growth was optimization of refining volumes, which I will talk about in more detail. Sales growth on the domestic market was due to increase of crude oil purchases.

Refining volume was 5.1% lower than in the first nine months of 2015 and nearly all of the decrease was due to optimization of refining volumes to ensure cost-efficiency. The reduction was 1.6 million tonnes in total, of which 0.3 million tonnes at the Mozyr Refinery, and the largest share, 1.3 million tonnes, at the Moscow and Omsk Refineries. The reduction of refining volumes was accompanied by a significant increase in the light product yield. In particular, output of high-octane petrol at our Russian refineries grew by 300,000 tonnes in spite of the 1.6 million tonne decline of volumes there. This reflected modernization of secondary refining facilities and work to optimize their operating regimes. Premium sales of motor fuels, that is small wholesale



and retail sales, increased by 3.5% in the first nine months of 2016 across the whole of the Company, including NIS, and growth of retail sales of these products in Russia was well ahead of the market. The petrol market shrank by 0.3%, while Gazprom Neft sales of petrol rose by 2.5%, and diesel sales were down by 0.5% compared with 0.9% growth of our sales.

There was a healthy increase in sales of premium lubricants during the first nine months of 2016, by 17.6%. This was achieved by balanced support for the distribution network, well-considered pricing and credit policy, and marketing actions to boost import substitution.

I should add that we are rapidly developing our premium sales of bitumen materials (polymer bitumen binders and emulsions), as well as bitumen-based products: sealants, road tapes and bitumen materials. Much of this production is at our newly acquired assets, which Alexey Yankevich already spoke about today, particularly at the Nova-Brit plant in Vyazma.

Those are our results in brief. Overall, we think that the results of our downstream business in the 3rd quarter and first nine months of 2016 were positive. We resisted the negative market trends and achieved a fairly strong result in our operations and in financial terms. Thank you.

Alexey Yankevich, Chief Financial Officer

Returning to financial results. The slide shows key financial indicators. What you see here are essentially the same figures. EBITDA growth of 4%, net profit growth of 13% and decrease in sales by 1%, which is the price factor. What it basically shows is that net income is growing despite a decline in the nominal value of sales, so profitability of the business is increasing, which is clearly positive for the company.

Now I'll go to factor analysis and comment on trends in operating income. As usual, the first slide shows year-on-year trends. As I have already said, in comparison with last year we were seriously affected by growth of the tax burden as a result of the tax innovations that have occurred: the effect is 23 billion, or about 7%. The remainder is impact of the external environment, which was also negative. That was associated with the fall in world oil prices, which was partially, but not completely, offset by change in the ruble exchange rate: overall impact was in the order of 14 billion, or 4-5% of the total result. So what we see is that we were able to increase operating profit thanks to internal factors, to efforts by management. The amount in comparable terms is about 50 billion rubles. That is a lot, but the overall growth taking account of negative factors was in the order of 4%.

If we look at the quarterly trend, external factors practically cancelled each other out: a small increase due to the price factor was offset by negative effect from the delay in change of the duty rate, so that all of the growth in EBITDA compared to the previous quarter was due to our internal factors and management efforts. Primarily, these were production growth, start-up and development of our major projects, including our efforts to optimize the production programme, supply logistics and retail sales.

The next slide deals with cash flows. As we have already much discussed with our investors and analysts, this year is the year of maximum investment in our major projects. Capital investments are very large, so our cash flow has gone negative so some extent: it was minus 30 billion rubles in the first 9 months. I would say that, for such a large-scale investment programme in the current macro conditions, that is not a bad result: the negative cash flow isn't too big. We also have investments, which are not consolidated in capex. These are projects that we are financing as joint ventures. The figure is 13 billion. But, really, it shouldn't be taken into account for the future, because, from next year, these projects will most probably use project financing, so investment by us won't be needed. We may even be able to repay some of the loans we have taken. So, really, the "true" figure for free cash flow is minus 30 billion. We also repaid several loans in accordance with our repayment schedule, so that our net financing gave minus 80 billion, some of our deposits were freed up, and the result was that we reduced cash balances by 75 billion. But cash balances are at an acceptable level, and we believe that it is optimal.

The next slide shows capex trends. It explains why we see the cash flows that we do. As I said, the increase here is related to investments in large projects. This can be seen from the second blue cube – the one that's slightly lighter than the cube below, representing brownfields. It shows growth of capital investments in greenfields due to start-up and development of our new fields. It causes growth in the "advances" line, the grey cube. The growth there is quite substantial, but the reasons are the same: the advance is mainly due to financing of major projects, major construction work that we are carrying out. The trend for brownfields, where we are keeping production more or less level, is neutral. What this shows is that we are managing to optimize,



to keep inflation in check. For the same level of production, we are investing roughly the same amount in brownfields. Part of the growth is also due to launch of the second wave of refinery modernization, after we completed the quality programme. We already announced launch of the second stage, and we now have second-stage modernization projects underway at both the Moscow and at the Omsk refineries. The growth, which you see, is mainly due to work on the first of these projects, the Euro+ project for modernization of the oil treatment facility at the Moscow Refinery. In the marketing segment we have a decrease. It's the only one of our segments where we have a decrease and the reason for it is that we are completing a fairly major programme of rebranding, so investments are down at this point in time.

I'll finish, as I usually do, with a description of our loan portfolio, the state of our borrowings. I would note that we recently obtained an improvement of the outlook on two of our ratings. Our Fitch rating went from BBB-negative to BBB stable. This makes us optimistic that we will eventually get back to investment grade. S&P has also revised our outlook, which has gone from negative to stable. We also did two good transactions in the nine-month period, including one in the third quarter, namely a very successful placement of bonds to the value of 15 billion in August. They are for 30 years, but with an effective life of five years, because they have a five-year put option, and for five years we got a rate of 9.4%, which is a very good result. It is just about the lowest rate for corporate borrowers since the beginning of 2014.

I will stop there. To summarize, the results really are good. It is particularly pleasing that we launched all of our scheduled projects on time, in some cases even ahead of time. And that enables us to plan our future activities and target fairly good rates of growth for next year, so you can expect very positive results from us in the future. That's all I wanted to say. We will be glad to answer questions.

Q & A session

Question №1

Evgenia Dyshlyuk, Gazprombank

Good evening and thanks you very much for the presentation. I congratulate you on the good results. I have four small, quite specific questions. First question: can you give some guidance on capex for the next year. Second question, again concerning guidance, this time for dividend payment for 2016: do you expect the payout ratio to remain at 25% of annual net income, or not? The third question: we know that the budget for 2017-2019 raises excise tax on diesel fuel, starting next year. Does this affect the Company? If so, can you give some monetary valuation of the effect? And the fourth question: is there any continuation of the story about possible cancellation of tax concessions for new fields of Gazprom Neft? Are there any developments in that regard or has the dialogue already been concluded? Thank you.

Alexey Yankevich, Chief Financial Officer

Thank you, Evgenia. Those questions should do us for the rest of the evening! You have asked just about everything that is likely to interest people.

I'll answer them one by one. Capex guidance for 2017. The business plan for 2017 is still under discussion, but I think you can expect roughly the same level as in 2016. And for 2016, as we have already stated in our plans, there is no change to date.

Regarding dividends for 2016, our policy on the payout as a percentage of net income will probably be unchanged. It's 25% of net income under IFRS. But what I can say that is positive is that the IFRS income will be significantly higher than for 2015, as you can already see from the nine month results, so total dividends per share, which is probably, what most concerns shareholders, should grow substantially. So I think that even 25% will be enough to ensure a quite significant increase in dividends per share.

Going onto the next two questions. The impact of excise taxes. This is hard for us to estimate in figures, because everything is bound to depend on the market, the balance of supply and demand and the market situation. So it is hard to give any estimates at present. As for benefits at new fields – you are probably thinking of Novoport. Here, as I said in the previous conference call, we have started a dialogue with the Energy Ministry and made good headway. We see that a compromise can be achieved and that makes us optimistic that a solution will be reached.

Evgenia Dyshlyuk, Gazprombank

Thank you very much. I hope that there will be more questions. Thank you.

Question №2

Ekaterina Smyk, Bank of America - Merrill Lynch

Good evening! Thank you for your presentation. Congratulations on the strong results. I wanted to ask about the fishbone technology: you showed on slide 12 that you were using this new technology. Could you please let us know at which field you are using it and, given that this technology gives a flow rate that is 40% greater than a conventional horizontal well, can you let us know how much greater the drilling costs are in comparison with an ordinary horizontal well? Do you have plans to use this technology intensively at your brownfields and, if so, how might this affect capex in coming years? Thank you.

Alexander Mikheyev, Head of Economics and Investment (Upstream)

Ekaterina, thanks for the question. We have started testing wells with fishbone technology at the East Messoyakha field. The cost is, of course, a bit more than for a horizontal well. We are not ready to draw any conclusions about cost for the moment, because, I repeat, the technology is at the testing stage. But we can definitely say already that the slight extra cost is easily compensated by greater flow rates.

Ekaterina Smyk, Bank of America - Merrill Lynch

Thank you. So, as I was asking, can we expect application of this technology at your brownfields? And there is the question: have you already obtained the 40% you talked about at Messoyakha, or is that what you estimate for typical fields? Thank you.

Alexander Mikheyev, Head of Economics and Investment (Upstream)

Certainly, we will consider using the technology at our brownfields based on the results of pilot projects and tests, and particularly at deposits and strata, which are similar to those at the East Messoyakha field where we are piloting the technology.

Ekaterina Smyk, Bank of America - Merrill Lynch

Thank you.

Question №3

Pavel Kushnir, Deutsche Bank

Good evening. In the presentation you significantly altered the capex breakdown by segment on slide 24. I wanted to do calculations for the third quarter, so I would appreciate if you could give a breakdown in the same format that you used in the first and second quarters. Thank you.

Alexey Yankevich, Chief Financial Officer

Yes, Pavel, we will do that breakdown. It's a difficult job, so we didn't show it to you in the presentation this time, but we will do it separately and send it to you.

Pavel Kushnir, Deutsche Bank

And one more question, if I may. Could you give guidance on production at the Messoyakha field this year and next year? And maybe even the production development profile up to the peak, which you expect in 2020? Thank you.

Alexander Mikheyev, Head of Economics and Investment (Upstream)

Pavel, as regards East Messoyakha our forecasts by years are: 3.1 million in 2017, (I'm talking about hydrocarbons); 4.4 in 2018; 5.5 in 2019; and 6.1 in 2020. That's for 100% of production.

Question №4

Alexander Bespalov, Citigroup

Good day, thank you very much for the presentation and congratulations on the strong results. It is good to see that the investment case, which you have been telling us about for some time and your growth strategy are beginning to take effect, that production growth is showing up in the financial results, but, for us, there is still a major factor holding back growth of Company capitalization, namely the relatively low free float in your shares. So the question is whether management views this as a problem and, if so, is anything being done about it? Thank you very much.

Alexey Yankevich, Chief Financial Officer

Alexander, unfortunately, I cannot answer you except by saying that you need to ask our shareholder. Really, that isn't a question for management, but for our shareholder, so that is who you need to contact. Thank you.

Question №5

Andrey Polischuk, Raiffeisen Bank

Good afternoon. Thank you very much for your presentation. I have a question: your results show a large reduction of transport costs, especially for export pipelines - by 20%. Can you give us more detail as to how this has been achieved and what we can expect in the future: will the average tariff go back up or will it remain as low? Thank you.

Alexey Yankevich, Chief Financial Officer

Andrey, what we have here is optimization of our logistics scheme, including the shipments from Novoport. We were operating a temporary arrangement there, and now it is permanent. But there may also be a structural factor, so we will send you a short summary separately for more accuracy. But just for now, straight off, I will say that, in the main, it is optimization of our logistics scheme.

Andrey Polischuk, Raiffeisen Bank

OK, thank you

Question №6

Evgeny Stroinov, Renaissance Capital

Good evening! Thank you very much for the opportunity to ask a question. I have a few questions. The first is about your production profile. Can you please say what your production plan is for next year? The second question is about your free cash flow in the light of production growth and no change in capital expenditures, as you were saying. What do you expect for free cash flow in 2017 and perhaps further ahead. Do you have any ideas about this? And the last question - about your joint ventures. When do you expect to start receiving dividends from SeverEnergia and what level can we expect? Many thanks.

Alexey Yankevich, Chief Financial Officer

Thank you very much for the question, Evgeny. The first question, about the plan for hydrocarbon production in 2017. We expect growth next year. I think we can definitely expect 5-6%, but, of course, you will see more exact figures when the business plan is approved. Regarding free cash flow, you can see that we are likely to finish this year with a small minus. In 2017 you should probably expect zero, slightly negative here and there, and then, probably, strong positive cash flow in 2018. The last question was about dividends from SeverEnergia. SeverEnergia is quite sensitive to changes in world oil prices. Tax on gas condensate is such that it is more sensitive to international prices, so forecasting is difficult so long as the market remains so volatile. If the situation on the oil market is positive, we may get dividends next year. But, probably, more substantial dividends are to be expected in 2018. But, again, everything will depend on world oil prices.

Question №7

Alexander Kornilov, Aton

Good evening, colleagues. I have a very short question. About interim dividends. Do I understand correctly that a decision on interim dividends for 2016 hasn't been taken yet and, if so, when do you plan to make this decision? Thank you.

Alexey Yankevich, Chief Financial Officer

Thank you very much, Alexander. It has already been decided that we will not announce interim dividends for six months. As for nine months, even if do announce dividends, the payment will be made next year. Because we had to launch several large fields this year and any launch delay has a major effect on future cash flows, we had to postpone a decision on dividends until next year. Most probably, we will not pay interim dividends this year, but given that our cash flows will improve next year due to the start-up of new fields, we will be able to pay a substantially larger amount of basic dividends, I mean that the total amount of dividends per share will be greatly increased, as I said at the beginning of the conference-call. So I think that the decision is justified. It's better to pay a significantly higher amount of basic dividends per share next year than to try and pay interim dividends now and, as a result, end up postponing field launches. I would remind you that, in principle, the initial decision to pay interim dividends was proposed by us as management. The situation then was that we had very good cash flow, attractive and favourable market conditions, and we decided to share our cash flow with shareholders and start to pay interim dividends. Now the situation has rather reversed, so we have decided to let this year go, but then gradually return to interim dividends as soon as our cash flows improve.

Alexander Kornilov, Aton

Thank you.

Anna Sidorkina, Head of Investor Relations

Ladies and Gentlemen, this is Anna Sidorkina, Investor Relations. That's all of the questions. Thank you for taking part and showing an interest. I'd like to say thank you to our Company management once more for the very detailed answers to all the questions. If you have any further questions, please contact Investor Relations. We will certainly send you what we have promised. Best wishes and see you in the next year!