



PJSC Gazprom Neft

Financial Results for 2016 22 February 2017

Anna Sidorkina, Head of Investor Relations

Good afternoon, ladies and gentlemen. We are pleased to welcome you to our conference call on results in 2016. Today, as usual, 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 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 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

Welcome, ladies and gentlemen. Please forgive us for timing the conference call so early today. We usually start at five in the evening Moscow time, but a lot of companies planned to release results today, so we had to bring the call forward.

And so to the points I wanted to make. 2016 was particularly tough for the oil industry, especially the 1st half of the year: we had the decline in oil prices, which continued in 2016, as well as an increase of the tax burden. But Gazprom Neft continued to increase its volumes and business efficiency in 2016, despite the difficult conditions. Production grew by 8%, which is definitely one of the best indicators in the industry. Operating income increased by almost 13%, and net income rose by about 83% to a record level of 200 billion (the highest figure in our history).

The important events, which I particularly want to emphasize, are commissioning and start of industrial production at the Novoport field and commissioning of the Messoyakha field. These two events are very large-scale and have major impact on our financial results and volume indicators in upstream business. In downstream, we are continuing to modernize our refineries. We are moving onto the next stage of modernization, which is increase of processing depth. The Euro+ project for construction of an integrated oil treatment facility at the Moscow Refinery is at the implementation stage. Then we have the Omsk plant with a small time lag. I would also point out that we are now shipping oil from Novoport round-the-year, which takes a lot of organizing, as you know. The arrangement works: shipments are running smoothly. We have also made a number of acquisitions to enhance high-tech production of our business units. We acquired Nova-Brit, which produces innovative bitumen materials. The synergy it offers will help us to further develop our programme of high-tech and high-margin bitumen production. And we acquired Rospolychem, a company that produces high-performance oils and lubricants, enabling us to raise our technology level in the lubricant segment and boost the share of high-margin products, which, together with a favourable situation for import substitution, means that we can make strong progress in the lubricants business.

My colleague, Alexander Mikheyev, will now give you a review of our upstream results.

Alexander Mikheyev, Head of Economics and Investment (Upstream)

Good afternoon, ladies and gentlemen. I am pleased to bring you our results for 2016 in exploration and production.



Let's start with the trend in reserves under development in our traditional production regions. As I have said before, efficient management of the resource base in traditional production regions is our priority, since it compensates for the decline in quality of reserves at these fields. In 2016 we acquired three licence areas: Yuzhno-Noyabrskiy, Kamennomysskiy and Severo-Samburgskiy. Two new fields were discovered: Novosamarskoye and the Zapadno-Chatylkinskoye. Another important event was the start of development work at the Otdalennaya (Remote) group of deposits. This is one of our biggest E&P projects, including six fields in Noyabrsk region. In 2016 we discovered a new field there with reserves in excess of 40 million tonnes, drilled five production wells, carried out 3D seismic work and added 12 million tonnes of initial recoverable reserves. These results are down to good planning and high efficiency of exploration drilling (about 96% in 2016).

Then for the resource base, the slide shows data for 2P reserves under PRMS classification. In absolute terms, reserves were 2.7 trillion tonnes of oil equivalent, which is an increase of 23% compared to 2015. The growth was largely due to revision of the resource base in our traditional production regions, growth at Slavneft and in our large projects (Novoport and Articgas). So the cumulative effect was 105 million tonnes of oil equivalent at the assets I mentioned.

Looking at hydrocarbon production, average daily output in the 1st half was relatively stable at 230,000 tonnes, but then grew strongly in the 2nd half of the year. This was largely due to the launch of infrastructure in the Novoport project (August 2016), start of industrial production in the Messoyakha project (September 2016) and the start of gas deliveries via the Ety-Purovskaya compressor station in October 2016. Quarterly dynamics (the right diagram) showed the same trend, a fairly level shelf in the 1st half and then growth to the end of the year. And we should emphasize that growth in the 4th quarter compared to the same period in 2015 was 8.3%.

As regards absolute production of hydrocarbons, we usually give factor analysis for liquids and gas. The increase for liquid hydrocarbons was just over 4 million tonnes of oil equivalent. As I already said, this was mainly due to the launch of the Novoport project, but the Prirazlomnaya project also made a major contribution due to the commissioning of new production wells. Turning to the gas contribution, the main driver here was the Arcticgas project, mainly operations at the Yaro-Yakhinskoye field and the achievement of design capacity at the Urengoyeskoye field. This includes the effect of a full year in parallel, since the Yaro-Yakhinskoye field was launched in April 2015 and Urengoyeskoye was launched at the end of the first quarter.

The key priority for our management is efficiency of production. And the next slide show that the substantial growth of hydrocarbon production has been matched by continued focus on costs, primarily operating and lifting costs. Absolute value of the opex indicator for 2016 was 1692 rubles per tonne of oil equivalent, and lifting costs rose by 4.4%. I would also note that all of the planned actions for cost optimization that management planned to implement in 2016 were successfully implemented. This mainly concerned greater efficiency in the development of tight reserves and limiting the volume of water pumped by our production enterprises in Noyabrsk region. We also focused in 2016 on the implementation of energy-saving technologies.

I'll briefly run through the main milestones in our major projects. As I said, we started oil shipments through the sea terminal in the Novoport project: the infrastructure facilities were launched at 5.5 million tonnes and a flexible system of logistics was put in place for the export of oil by tanker. In the Messoyakha project we started commercial operations at the East Messoyakhsky license area in September started delivering oil to the Transneft pipeline system in the same month, we obtained relief on export duty, which significantly increased the economic attractiveness of the project, and we launched a gas turbine generating plant with capacity of over 90 MW. In the Prirazlomnaya project we shipped 32 tankers of oil in 2016, drilled four wells, commissioned social infrastructure (a shift camp) and we are now making preparations for construction of a dedicated onshore heliport.

Technological development remains our key priority and the next slide shows how we worked faster in 2016 to implement relevant actions. The slide shows the main results of drilling support work in 2016. We continued to reduce the drilling cycle for high-tech wells, by 46% in 2016. At our joint ventures, Salym Petroleum Development launched a mixing plant for ASP components, which gave a 10% increase in oil extraction efficiency. Khantos completed the first 30-stage frac job at a drilled well at the Priobskoye field in 2016. Overall, time required for fracturing operations was almost halved. As regards drilling technologies, we successfully drilled multi-hole "fishbone" wells last year (as already reported in our quarterly reviews).

That is everything I wanted to say. I'll hand over to my colleague Vladimir Konstantinov.



Vladimir Konstantinov, Head of Economics and Investment (Downstream)

Good afternoon, ladies and gentlemen!

The Company delivered 8.2% more oil in 2016 than in 2015. Most of the growth went to export, thanks mainly to increase of production and supply from Arctic fields. Deliveries of oil on the domestic market also grew, by about 20%. The decrease was in oil supplies to CIS countries, mainly due to reduction of the oil supply schedule to Belarus in the 3rd and 4th quarters of 2016. There was also a reduction in the total volume of oil supplied for refining, by 2.7%. The main reason for that was refining efficiency, which I will say more about. We kept you updated on refining efficiency through 2016 at earlier conference calls. Efficiency was quite good in the 4th quarter, considering the tax conditions. It fluctuated around USD 5 per barrel.

Oil refining. As I said, the volume of oil refining in 2016 was 2.7% lower than in 2015. Mainly because it would have been inefficient to refine more oil, particularly in the 2nd and 3rd quarters of 2016. In the 4th quarter the difference between our refining target and the volume we actually refined was insignificant – the 2nd and 3rd quarter factors didn't play a role. Despite the overall decline in oil refining, we increased refining of gas condensate: the growth was about 200,000 tonnes and the total volume of gas condensate refining was about 1.5 million tonnes. Technology efficiency indicators improved in 2016: depth of processing rose by 0.5 percentage points, thanks to YANOS and the Moscow Refinery. There was a slight decrease of processing depth at Omsk, to do with comparative efficiency of supply of dark marine fuel and fuel oil for export. The situation through the year made it more profitable at certain periods to supply fuel oil for export instead of marine fuel. We had a substantial increase in light product yield, by 2.5 percentage points. This was due to several factors: management work to improve the product selection structure; growth of gas condensate refining; and another important factor was reduction in the volume of oil refining due to full loading of secondary refining units

We believe that we performed well on motor fuel markets in 2016. The total increase in premium sales was about 4%, including sales by tank farms and filling stations. We increased petrol sales by 2.3% and sales of diesel by 0.9% in a context of overall market decline in retail sales of both petrol and diesel, respectively, by 0.5% and 3%. We achieved this by raising sales efficiency at individual stations, implementing a sales efficiency programme, and by opening new outlets. We opened, rebranded, built and rebuilt more than 60 filling stations in 2016.

Our performance in other product businesses was also successful in 2016, given the conditions we had to operate in. We kept our market share and even increased our share for aircraft fuel, lubricants and bitumen. Lubricants showed the biggest increase, by 2.9 percentage points to give us 20% market share. Growth in premium sales of lubricants was about 17%. Generally our focus wasn't just on maintaining market share, but also on expanding our presence and increasing sales efficiency. We increased the number of airports where we work in 2016, we set up bunkering operations in new locations, we launched new premium brands of oils and lubricants, and we increased our sales of premium bitumen products.

So downstream performed quite well, despite the macroeconomic difficulties we had to deal with.

Alexey Yankevich, Chief Financial Officer

Thank you. Ladies and gentlemen, I will round off our presentation by looking in more detail at our financial results.

As I already said, we had major growth of both operating and net income in 2016. Certainly, the growth of net income was affected by the exchange rate, but it was also largely determined by the growth of operating results. We also see positive progress quarter-on-quarter. Overall, total sales and the level of operating income increased: operating income increased by 8%, and lowering of net profit loss has a technical explanation – we created provisions for impairment of assets, due to change of estimates and creation of provisions under IFRS. This is a non-cash thing, a technical operation. Leaving out these one-off operations, net income grew quarter-on-quarter.

We like to give a factor analysis of change in our operating results, distinguishing factors that we can influence and external environment factors. It is interesting to note that impact of the external environment was neutral as such: 2016 was practically the same as 2015 in ruble terms, the price reduction was almost compensated by the exchange rate change, and the main negative factor was change in the tax regime (growth of the tax



burden and indexation of mineral extraction tax). So, overall for the year, the "external environment" left us worse off by about 30 billion. On the right side, you see the substantial contribution to growth of financial results made by internal factors: business development, growth of volumes (mainly from the launch of new projects) and work to improve efficiency at our mature fields; and, for downstream, increase in retail sales, consistent work to optimize the product basket and processing volumes, and work on costs. The final outcome of all this was increase of operating income by about 80 billion.

Analysis of the quarter-on-quarter trend for operating results is simpler. We separated out the impact of internal factors, which is not very great, since the 3rd quarter is traditionally very good and the 4th quarter is already the winter period, a period of falling demand, so it is always a bit worse than the 3rd quarter, by definition, but, thanks to our efforts, it was at about the same level – the total impact was plus one billion. The recovery in oil prices in the 2nd half of the year gave an extra boost (it continued in the 4th quarter), as did the lag in change of export duties.

Let's move now to the analysis of cash flows. The general picture here reflects our expectations and the discussion that we are having with our investors and shareholders about the distribution of our investment programme over time. You know that we have an investment peak in 2016-2017. Unfortunately, it has coincided in time with a highly negative external environment. Average oil prices in 2016 were at their lowest ever since the previous crisis of 2008, so, of course, in these conditions and with the growth of the tax burden, it was very difficult to keep positive free cash flow: we went a certain way into negative (by 64 billion rubles). But you should note that the new projects item can also be referred to investment activities – these are loans that we issued to finance our major projects. So we get total free cash flow of minus 79 billion rubles, taking account all new projects, consolidated and unconsolidated under IFRS. And I should say that we expect to improve our cash flows and improve free cash flow this year. We will approach zero or positive values.

As for trends in our investments, as I said, we are going through an investment peak and that explains the growth of investments. In principle, the growth is in one segment, which is "Advances issued" (65 billion rubles in 2016 compared with 35 billion in 2015). The advances mainly relate to large-scale projects, in both production and refining. The item sometimes also includes works that haven't been commissioned or finished (the part of works, which haven't been commissioned and haven't been classified as capex under accounting standards). But all this, one way or another, is investments in our major projects, particularly Novoport and Prirazlomnaya, and our refining projects. And, as I said earlier, we are entering the implementation stage of the first phase of the programme to increase refining depth, mainly at the Moscow and Omsk refineries.

As regards investment trends at mature fields: we were even able to slightly reduce the level of capital investments in mature fields thanks to internal optimization, including the replacement of some drilling projects by more efficient well workovers. As for new projects, formal capex was lower, but if we add in advances, then we get growth.

Capex figures in refining are not very indicative – they also need to be analysed taking account of advances, in which case there will also be a plus compared with 2015. All our other items are roughly unchanged from the previous year.

I'll conclude the financial part with a review of our financial situation. We are well placed in terms of financial stability, because we don't have a big share of borrowing falling due in the next year or two (as you can see in the graph). Also we managed to increase the average maturity of our loan portfolio from 3.3 to 3.6 years in 2016, and we will work to increase it further. Another positive thing to note is that, in September-October 2016, Standard & Poor's and Fitch improved our outlook from negative to stable. And just today we had the same news from Moody's. So the rating agency trend is positive and we hope for an increase of our ratings in the future. In addition, we have continued to show that we can borrow efficiently, even in difficult conditions. We don't just secure volumes – we do so efficiently. In particular, in August we placed bonds to the value of 15 billion rubles with a five-year option (effective maturity is five years) at a rate of 9.4, which was one of the lowest rates achieved in the corporate segment last year.

That's everything I wanted to say in my part of the presentation and I am ready to answer your questions.

Q&A Session

Question №1

Laura Gardner, Debtwire

I would like to know more about plans for the capex level this year. And are you planning to issue more bonds on the market or to take on extra debt?

Alexey Yankevich, Chief Financial Officer

Yes, thank you very much for the question. I'll start with the first part. There is really no change as regards capital investments. We are sticking to the business plan, which was approved by the board of directors, so a level of about 380 billion, as we said before.

Regarding the second part of the question, about borrowing. New borrowing is possible in principle. It could be used to finance the existing loan portfolio this year. We are considering various instruments, weighing them up, including bonds and loan agreements. The market is not bad now, but we have not taken any decision so far.

Thank you.

Question № 2

Ekaterina Ilyushenko, Union Investment

Good afternoon. Could you please give a breakdown of capital investments? I'm particularly interested in the refinery investments.

And the second question is about the longer-term outlook. The share of large projects in company production is increasing and they have an absolutely different tax base, so profitability of the portfolio could change a great deal in the future. We can say that the new projects, which you have launched, are much more profitable than mature fields. How do you plan to distribute the cash flow as regards return to investors through dividends?

Alexey Yankevich, Chief Financial Officer

Thank you for your question, Ekaterina. Let's start with a breakdown of capex. About 30% will go to downstream and most of that is refining. All the rest is mainly upstream. And upstream divides roughly equally between new projects and mature fields. We will provide a more detailed breakdown later, if necessary.

As for the distribution of cash flows, you are absolutely right: shareholders are fully entitled to expect an increase in dividends if there is an increase in our cash flows. We will be guided more by the absolute amount of dividends and dividends per share, rather than looking at a percentage. So, as regards monetary policy, we still adhere to our benchmark of 25%, but taking into account the fact that we expect increase of net income. So the dividend will grow in absolute terms. It will grow significantly this year in comparison with last year and we also expect a positive trend in coming years in the level of absolute dividends and of dividends per share.

Question № 3

Pavel Kushnir, Deutsche Bank

Good afternoon and thank you for the presentation.

In your talk, you mentioned creation of provisions for asset impairment. In particular, the MD&A says that the decline of net income in the 4th quarter was due to provisions for the impairment of non-current assets, and also says that increase of depreciation expenses is connected with recognition of an impairment loss on oil and gas assets in Iraq. Could you give us the exact figures for provisions under the first and second item? Thank you.

Alexey Yankevich, Chief Financial Officer

Thank you very much for the question. Both aspects relate to the creation of provisions for impairment of assets in the Middle East. We reclassified these expenses from other costs to the depreciation line, and that is



mainly what the changes are to do with. The provisions, which we created in the 4th quarter – about 10 billion rubles – refer mainly to assets in the Middle East. We can send you a more detailed breakdown later if necessary.

Question №4

Ekaterina Smyk, Bank of America - Merrill Lynch

Good afternoon! Thank you for the presentation. Could you please comment on the information on the 7th slide, about new fields that you are plan to launch in the next 3-4 years. The slide shows that two of them will be launched in 2017-2018. I would like to know how big those fields are and the potential production volume up to 2020. The slide shows the production shelf, but it is not entirely clear how production will be distributed between these projects. Thank you.

Alexander Mikheyev, Head of Economics and Investment (Upstream)

Thanks for the question. The new areas, which we will commission up to 2020, are the Yuzhno-Noyabrskiy, Kamennomysky, Severo-Samburgskiy areas, the Chatylkinskoye field, the Zapadno-Chatylkinskoye field, and the Kholmistoye, Vorgenskoye, Ravninnoye and Yuzhno-Udmurtskoye fields. So the contribution to production from these fields up to 2020 will be insignificant. We can send you a detailed breakdown separately on your request, but I would emphasize that the contribution will be insignificant.

Kuyumbinskoye and Chona are large fields. Primarily the Kuyumbinskoye field, since it will launch in 2018-2019. We will tell you more exact volumes later, because at present the field is at a stage of exploration where the estimates are changing. We will be glad to provide more detailed information.

Ekaterina Smyk, Bank of America - Merrill Lynch

Thank you very much! One small clarification: the shelf of 3 million tonnes is only for oil?

Alexander Mikheyev, Head of Economics and Investment (Upstream)

The figures are only for the Otdalennaya group of fields: the six fields I listed above. So the production peak of 3 million tonnes is for oil in 2025.

Anna Sidorkina, Head of Investor Relations

Colleagues, thanks to everyone for taking part in the conference call. Thank you very much. Thanks to our management for their detailed explanations and for a good presentation. Best wishes and enjoy the long weekend!