Press Conference

Gazprom's Power Generation Strategy

May 17, 2017

MODERATOR: Good morning, dear colleagues. We begin a series of Press Conferences in the lead-up to the annual General Shareholders Meeting of Gazprom. Today, we will address the Company's activities in the power industry.

Denis Fyodorov, Head of Directorate at Gazprom and Director General of Gazprom Energoholding, is taking part in today's Press Conference.

I give the floor to Mr. Fyodorov, and then we will move on to your questions.

DENIS FYODOROV: Good morning. I will try to be brief in my presentation in order to devote more time to the questions that you may have.

(Slide 1) Regarding the focal points. In 2016, we boosted electric power generation. The thermal power output showed a slight increase, apparently due to low ambient temperatures. There was quite a decent increase in revenues and EBITDA.

Last year, we brought onstream two coal-fired power units: a 660 MW power unit at the Troitsk SDPP and a 330 MW power unit at the Novocherkassk SDPP.

Construction operations at the Troitsk SDPP were extensive in terms of scope and timeframes. All of the equipment was produced in China. The unit features a high degree of automation. Its performance is not flawless, but we are now eliminating the "childhood diseases" which are usual for new units. The project is rather challenging, considering that absolutely no pulverized coal-fired units have been built in Russia over the last 10 to 15 years. We are experiencing certain problems with equipment operation, but I think we will resolve them within six months.

The Novocherkassk SDPP is using the circulating fluidized bed technology. This is the only domestic 330 MW unit using this technology. We have eliminated all the bottlenecks there, and the unit is operating properly.

Last year, we started the full-scale implementation of the construction project for the 360 MW Grozny TPP.

By mid-2017, we will complete two 50 MW turbines at the Central CHPP in St. Petersburg. Given the plant's location in the city's very center and the high electrical load that needs to be transferred, we will be switching the electric grids until about September. The power unit is ready now and we are going to officially launch it anytime soon.

(Slide 2) The next slide depicts in more detail the fluctuations in electric and thermal power output with breakdown by companies.

(Slide 3) The key financial results are indicated here according to Russian Accounting Standards (RAS). It's clear that all of our financial indicators are fairly good. The growth is strong enough in all segments. The net profit of Gazprom Energoholding has risen by 65 per cent.

(Slide 4) Regarding the debt burden. This is the first year when we started to reduce the debt burden. The shareholders' dividends will be calculated taking into account this reduction. As I've already noted, we are not planning any new, large-scale investment projects for the time being – there are no investment preconditions for that. The electric power and capacity market environment doesn't inspire us to invest in new generation development projects. Hence, our main objectives are to pay out dividends to shareholders and to cut down the net debt. As you see, the debt fell from RUB 157.7 billion to RUB 144 billion in 2016.

(Slide 5) Regarding the dividends. We are putting forward a proposal at the shareholders meetings of Mosenergo and TGC-1 to pay out 25 per cent under International Financial

Reporting Standards (IFRS) in line with the decision made at the meeting with the Chairman of the Gazprom Management Committee held last year. With regard to OGK-2, we opt for 25 per cent under RAS just because the resulting figure is higher than the one under IFRS.

(Slide 5) This slide shows the Company's debt-to-EBITDA ratio. Mosenergo and TGC-1 have demonstrated very good results. OGK-2 has a slightly higher ratio, but within the acceptable boundaries. Let me stress once again that our main efforts are focused on reducing the debt burden and paying out dividends.

(Slide 6) We continue running the cost optimization program, conduct import substitution activities, and make efforts to divest non-core assets, which we still have mostly due to Mosenergo and MOEK. It's clear that today's market environment is not very well-suited for the sales of non-core assets, but we are doing our best to sell them at the highest possible price. It means that we don't seek to dispose of our non-core assets regardless of the price; our aim is to provide the maximum benefit to the Company.

(Slide 7) Regarding our key development priorities. We were instructed to update Gazprom's power generation strategy, and we are doing it now. If the decisions are made in favor of the so-called CSA Prime, we have a number of projects that we deem necessary to implement. And we will execute these investment projects given the sufficient incentives. So far, there have been no final decisions on the part of the federal executive bodies. There is a common understanding that the thermal power industry should retain all of its revenues and proceeds, and they should not be distributed to other segments. However, nothing particular has been decided at this point yet.

We will continue to optimize operating and investment expenditures. We are phasing out old capacities. By now, we have agreed to decommission around 1,000 MW by 2022.

We are also running capacity construction projects. We have started to construct a large substation in the Amur Region and we are designing the first stage of the power plant meant to supply electricity to the Amur Gas Processing Plant.

We always discuss the acquisition of core assets, but there are no such negotiations underway at the moment. There are no interesting offers right now. Of course, we are following the situation in the domestic power industry, but nothing worth talking about is taking place.

Regarding international projects. The power plant in Pancevo is under construction, and negotiations are being held on the selection of equipment. Just yesterday, I met with representatives from Siemens and Metka, a Greek company that won the contract for the plant's construction. We need to adopt a final decision on the plant's capacity. I think we will finalize it within one or two weeks, and Metka will start their work on the project.

We are closely following the dividend payout process. Every year, we raise the dividend amount at Mosenergo, TGC-1, and OGK-2. The highest dividend increase is expected at Mosenergo – we paid out around RUB 2.2 billion in 2015 and we are going to pay out some RUB 3.4 billion this year. TGC-1 paid out RUB 937 million in dividends last year and will pay out RUB 1.3 billion this year. In OGK-2, it was RUB 600 million last year and RUB 874 million this year. The debt burden is reduced through operating cash flow from CSAs.

(Slide 8) Our major problems are related to St. Petersburg's heat supply market. They are still unresolved and we see no prospects for solving them. A positive aspect, perhaps, is that the debts are growing not as fast as they did before. However, the problems are still there and they remain acute: in St. Petersburg, the outstanding debt for heat supplies is RUB 6.1 billion, of which RUB 4.2 billion is owed by managing companies partially owned by the city government.

As regards the investment program for 2017, the tariff structure of St. Petersburg Heating Grid allocates only RUB 2.4 billion for investments in the repairs of heating networks. In reality, we are investing more this year. This is due to the fact that each year we lay the groundwork for design activities. We mostly invest extra-tariff funds in design so that we are always able to work with clear and straightforward design documentation and comprehensible figures for the next

two or three years.

As I've repeatedly said before, these funds are obviously not sufficient to maintain the city's heat supply system in adequate technical condition. It requires larger investments. And, of course, a sound payment discipline should be established. Despite the fact that we conduct negotiations and everything is clear throughout, it never goes beyond talking and signing certain documents with instructions that are never going to be fulfilled. Unfortunately, our problems in St. Petersburg are quite serious. To be honest, we don't know yet how we are going to deal with them.

As for the system-wide challenges facing the industry – these are, first of all, the preservation of the required gross revenues in the electric power industry and the utilization thereof for the industry's needs, without distributing them among nuclear, green energy and other projects. Thermal power industry is the backbone of the domestic power industry and, naturally, of the heat supplies across the whole country. We live in a cold climate, which is why heat is in higher demand by Russian consumers than electricity. I think it is necessary to create incentives. There is no doubt that the CSA program has provided great benefits and made it possible to upgrade a number of facilities in Russia, but this definitely doesn't have to stop at this point. This investment program should be further continued and developed. We hope that federal authorities will make the appropriate decisions and we will be able to start the capacity upgrade program.

A very big challenge for coal-fired power generation in eastern Russia is that, despite higher operating costs, its prices are as low as those of gas-fired power generation. We see widespread decommissioning of coal-fired capacities in central Russia. I consider this absolutely erroneous in terms of national energy security, which becomes compromised as a result. This calls for a solution.

The other challenges, which, as we think, have already extended to the national level, are coal-related problems, and they are especially acute at the Novocherkassk SDPP. Coal is supplied in very small quantities and its quality is very poor. Today, we are combusting this coal using gas, which essentially makes coal use at the SDPP economically unviable. Besides, the supplies make up roughly 60 per cent of the contracted amount – basically, they just don't bring us coal. We had suppliers who delivered only 10 per cent of what we had requested. This is despite the fact that all of the coal companies operating in the region are fighting for every kopeck and every extra ton of coal during tendering procedures. But when it comes down to it, nothing happens. I raised this issue before the Rostov Region Governor and the Russian Ministry of Energy. As far as I know, they had several meetings about it.

This winter, we had real concerns about maintaining the required amounts of coal in our storage. I can't accuse coal companies of anything, as I don't have the objective information, but for all I know, all coal is exported. As soon as the export price increases, coal supplies are interrupted, or rather, we only receive the coal that is not suitable for exports. I don't want to call it soil, but it doesn't meet the quality standards specified in the contract and it is not the coal for which the plant had been designed. We sent several coal trains back to the suppliers so as to get decent coal. As a result, we have approximately 60 per cent of the requested amount at the moment, and this is a difficult situation for us.

We are even thinking of building a second string of the gas pipeline stretching to the Novocherkassk SDPP. After all, there is a risk that we will no longer be able to meet the coal stock requirements outlined by the Ministry of Energy, which could result in administrative or even criminal charges against the leadership of OGK-2 and Gazprom Energoholding. From my point of view, the situation is unacceptable, but, unfortunately, we can't improve it, and it's hard to tell who can. I have met with all shareholders of the companies that supply coal to the Novocherkassk SDPP. Donugol has improved and increased its supplies, but the other companies are supplying less than required.

If we build a gas pipeline, we will give up on coal, except for the new 330 MW power unit. We are aware of the social issues that may arise in the Rostov Region – we consume around 60 per

cent of coal produced there. This will definitely have social implications for miners.

The situation is quite tense. There is a possibility to build a gas pipeline and we even have an understanding of its future costs. But it's not even so much about the economic viability of the pipeline as it is about the operational safety of the power plant. This winter, some suppliers delivered less than 10 per cent of the contracted coal. Take, for instance, the Obukhovskaya mine. We sent them a termination notice.

Speaking of the greatest and most pressing issues we faced in 2016, there is also the ongoing situation with the debts accumulated in St. Petersburg. Despite myriad meetings, discussions and protocols, we don't see any progress in terms of debt collection or any attempts to settle overdue receivables. The coal issue at OGK-2 is rather acute as well.

Let me conclude my speech here. I am ready to answer your questions.

QUESTION: Polina Stroganova, Interfax agency. Can we expect dividend growth at subsidiary companies based on the 2017 results? What percentage of the net profit will be allocated for the dividend payout?

DENIS FYODOROV: We have a clear instruction from our parent company – to pay out not less than 25 per cent under IFRS. It's the minimum amount that was specified in the official decision. As for specific figures for 2017, we need to see the financial results and the debt burden for the year first, and then, based on this information, we will make a decision on the amount and form of the dividend payout together with Gazprom's relevant departments. I can't tell you the exact percentage now, but it will be no less than 25 per cent under IFRS.

POLINA STROGANOVA: Will they grow in absolute terms?

DENIS FYODOROV: We will certainly make every effort to ensure their growth in absolute terms.

QUESTION: Anastasia Lyrchikova, Reuters agency. Could you clarify one thing about the dividends: why 25 per cent? In 2016, you said that it could be 35 per cent under IFRS.

Could you give us a forecast on the financial results under IFRS for 2017?

DENIS FYODOROV: We still don't have all of our business plans approved and agreed with the relevant departments of Gazprom, so I will refrain from making estimates for 2017. I think we will resolve all issues by June and publish an official press release with the estimates.

Why do we pay out 25 per cent? We believe that this volume helps maintain a reasonable balance between debt reduction and dividend payouts. That is, the revenues that we receive are used to reduce debt and pay out dividends. And we have decided that we would pay out this amount of dividends and make consistent efforts to reduce the debt burden of our generating companies.

ANASTASIA LYRCHIKOVA: What is the planned reduction of the debt burden in 2017 and what tools will be used for that purpose?

ANSWER: Evgeny Zemlyanoy, Deputy Director General for Economics and Finance, Gazprom Energoholding. In April 2017, we reduced the debt burden by more than RUB 20 billion against late 2016, mainly in Mosenergo and TGC-1. Before the year's end, we are planning to repay additionally up to RUB 10 billion across the Group.

ANASTASIA LYRCHIKOVA: RUB 30 billion in total? How are you going to achieve that?

EVGENY ZEMLYANOY: This is an approximate amount. It will be achieved via the cash flow. The first quarter of this year was very successful. We are also optimizing the investment program: we are borrowing less now.

DENIS FYODOROV: We are paying the debt through the free cash flow.

QUESTION: Vyacheslav Gorodetsky, B-Port agency. A comprehensive investment project for

the upgrading of the heat supply system until 2030 has been developed in the Murmansk Region. Its provisions differ from those of the usual urban heat supply schemes. For instance, it is proposed to switch one of the boiler houses to coal. At the same time, you are saying that central Russia is suffering from coal shortages. Can we expect similar problems in Murmansk?

What is your vision of the development of TGC-1's heat supply sources in the Murmansk Region, I mean the Apatity CHPP and the Murmansk CHPP?

It is the Year of Ecology. Can you review the measures being taken to mitigate environmental impacts in the regions?

DENIS FYODOROV: We have actively discussed this issue with the Governor of the Murmansk Region. The Company has allocated around RUB 500 million for environmental projects in the Murmansk Region. Out of this amount, some RUB 300 million will be used to build an enclosed loading rack for the fuel discharge system. I know that the smell from the transfer of fuel oil from railway tanks into the fuel preparation system poses a major problem. This is why we are building an enclosed system. We are already ordering equipment, and we will install the system by the middle of next year.

As for switching power plants to coal, we have quite a lot of experience in cooperating with coal companies – this goes for all of our coal-fired assets, not only the Novocherkassk SDPP. My opinion is that engaging in these projects is very risky unless there is a clear contract specifying a fixed price for coal, not a price formula but distinct price indices. Besides, Murmansk is a shipment terminal for coal export, as far as I know. As we were looking into and assessing the possibility of converting power plants from fuel oil to coal, we saw the export volatility of coal. And, considering that it is a terminal, we would essentially have to buy export coal at the export price reduced by charges for transportation to the ports of delivery.

Honestly, it's a rather risky project in terms of cost efficiency, given the current prices for capacities and electricity. With regard to electricity, we have 12 MW (installed capacity of the Murmansk CHPP), but the plant mostly generates thermal power. If we also add the investment component to the already-high heat tariff in Murmansk… We ought to be very careful in such matters.

It's one thing when you have clear-cut agreements with coal companies, with guaranteed volumes and fair prices. I know that coal companies are going on about how efficient the construction of a coal-fired power plant in Murmansk would be. But I am very cautious about this. There could hardly be any issues with coal shortages, but coal pricing is bound to be a problem. Besides, there is no point in forecasting the cash flow 10 to 12 years ahead – our investments will not pay off in 3 years, especially in coal-powered generation. In any case, we reviewed those options for several years and never ventured an investment decision. For now, we are focused on environmental protection.

Indeed, we are monitoring the state of our equipment as we are well aware that supplying heat to Murmansk consumers is our vital mission and that it is extremely cold there and the heating season is long. Therefore, we monitor the technical condition of our power plant, which essentially serves as a boiler house, and we are ready to invest in it if the need arises.

As for environmental protection, we will solve the main problem in the middle of next year. We placed an order for equipment, we will start installation as soon as it's delivered, and by mid-2018 the issue will be closed. We are aware of the problem and we are ready to handle it.

QUESTION: Olga Myagchenko, Delovoy Peterburg newspaper. A question about St. Petersburg Heating Grid. Given its history, the situation with its tariff-setting and the negotiations on the purchase of shares from TGC-1 by the St. Petersburg authorities, it seems that the authorities are deliberately trying to exacerbate the deterioration of the heating networks to make TGC-1 transfer this asset to the city for free. Of course, that's not true, but it seems to be. The deterioration of networks in St. Petersburg Heating Grid is 2.5-fold worse than in the networks of St. Petersburg Fuel and Energy Complex (TEK). When will you be ready to transfer

this asset to the city for free or even pay extra to get rid of it?

DENIS FYODOROV: We are a commercial company with a fairly large amount of social responsibility, which we are not going to abrogate. Nevertheless, we are a commercial company and we believe that we have always been fulfilling all of our obligations for creating heating networks.

As regards the city authorities, we don't even see a willingness to meet the obligations they assumed. I am not even talking about the outstripping growth of tariffs we agreed on. I am talking about a sustainable payment discipline in managing companies in which the city authorities hold a stake, most often a controlling stake. Thus, we have repeatedly told them, "Pay off the debts, we will not use them for dividend payouts or debt settlement, we will invest them in projects that we are ready to coordinate with the city authorities and that will help improve heat supply in St. Petersburg. That is, we will just allocate these funds to the heating networks."

Give the heating network away for free? I don't really believe in miracles. Even the law prohibits the transfer of a company free of charge, let alone paying extra for it to be taken. Besides, the company has a pretty high book value and a transfer will lead to losses, albeit paper losses. And these paper losses will immediately affect the volume of dividends paid out to the majority shareholder and minority shareholders. So, I think it's a road to nowhere.

Speaking of rubles and kopecks, I think that we have offered the city authorities an absolutely correct scheme of asset transfer. We proposed that St. Petersburg Heating Grid take the heating facilities and classify them as an equity contribution, thereby increasing the ownership to a majority stake, i.e., to 75 per cent plus one share, or to 100 per cent. That is, no money will be needed from the city's authorities, all they will have to do is contribute the assets in return for an additional share issue, and the matter will be settled. There will be no economic or financial problems with it. Unfortunately, due to many reasons, we can't resolve even this one issue. I don't want to go into detail or name names, but the situation is very strange. I think we manage to maintain heat supplies at an acceptable level, given their current state. But I think the heat supply system of a city like St. Petersburg should match the high rank of the city with its history and status in the Russian Federation.

I see the importance attached to heat supplies by heads of nearly all Russian constituent entities where we provide heating. For instance, the Moscow authorities, including even the Mayor, hold regular discussions on how the heating season is going on. Not to mention the deputy mayors – we meet regularly. The Murmansk municipality also places high emphasis on heating issues. I see the Governor of the Murmansk Region more frequently than the Director General of TGC-1 does. All of them pay great attention to heat supplies.

Meanwhile, St. Petersburg officials seem to understand everything perfectly well in face-to-face encounters, at meetings with or without official minutes kept, but nothing happens. I don't think they are deliberately trying to finish off St. Petersburg Heating Grid. We won't let that happen. The current situation can't be neglected – the heating networks should be repaired.

What is an investment program worth several billion rubles for a city like St. Petersburg? I am speaking of the investment program excluding technological connections. The connection fee makes up around RUB 500–600 million per year there, but the expenses are in fact incurred by the new consumers. This year's program in Moscow is worth RUB 14 billion, while in the past year we earmarked RUB 17 billion for it, and the year before it had been RUB 21 billion. The volumes are immense. And yet, the Moscow tariff is higher despite the more extensive market, and the investment program is more costly. It should be the other way round – the tariff should be higher in a smaller market. Besides, there is a significant difference, to put it mildly, in the deterioration of heating networks in Moscow and St. Petersburg.

This is why I consider proper heat supply a priority issue that needs to be addressed by the local authorities of the Russian Federation. This subject should be a matter of great concern.

QUESTION: Alexey Kirichenko, Kommersant newspaper. Based on the tariffs, this year's

investments in St. Petersburg stand at RUB 2.4 billion, and you are investing RUB 3.1 billion. This makes the difference of RUB 700 million. For how many years will Gazprom be able to invest its own funds in the heating networks?

My second question is related to the actual completion of the CSA program by TCG-1. When are you going to put onstream the generator unit of the Central CHPP? How much have you invested in the CSA program, particularly in TGC-1? What are the expected returns on these investments? Have you faced any financial risks in connection with CSAs? Are you facing any now?

DENIS FYODOROV: Regarding the advanced financing or extra financing for TGC-1 and St. Petersburg Heating Grid: we have to minimize it as the Heating Grid is unable to make significant investments in excess of the tariff. So, the investment program that is not recovered by the tariff is declining from year to year. Next year, the gap between the tariff and our investments will probably be wider.

We have already crossed the point of no return: the debts are growing and the funds don't reach their recipients. The Federal Antimonopoly Service has formulated several decisions to deal with it. As I know, they are not widely reported as they favor TGC-1 and actually oblige the city authorities to adopt the method of separating costs on heat and electricity. This will be quite helpful for TGC-1 in terms of generating additional cash flow and balancing out some funds that were not accounted for in the tariff. So, we hope that all instructions of the Antimonopoly Service will be performed by the executive authorities of St. Petersburg.

Concerning the CSAs: they don't involve any additional risks for us. The Central CHPP – the 100 MW gas turbine CHPP project – was rather cash-consuming as it is located in the very center of St. Petersburg. A lot of restrictions were imposed on construction, switching and other activities, so it exceeded the conventional CAPEX. The approximate cost of the other construction projects was about RUB 100 billion.

CSA is a very transparent mechanism. The debts owed by the North Caucasus and other distribution companies don't apply to CSAs. That's why we don't see any risks here. Just as we have fulfilled our CSA obligations, the federal executive authorities are fulfilling theirs, except for the day-ahead-market (DAM). I raised this subject at the meeting of the Ministry of Energy held before the May holidays.[1] Companies receive less that the entire amount of revenues on the previously built power plants. The DAM rates[2] should have been reassessed for the power plants commissioned before 2012, but this was not done and we recorded this in the minutes of the meeting. The revenues in the electricity market were lower than planned and, in accordance with the Government's decree, these revenues should be compensated through the capacity market.

At present, reassessment is being carried out for all power plants commissioned after 2012, but it doesn't cover the plants commissioned before 2012. The total capacity of all companies that should be subjected to reassessment is around 4 GW. The Minister ordered to introduce this item into the assignments for the Ministry of Energy. Therefore, we are dealing with this issue now. There are no other risks related to CSAs.

QUESTION: Olga Kvashina, press service of the Krasnoyarsk SDPP-2 (OGK-2). Right now, you are finalizing an equipment upgrade program as part of Gazprom's efforts to update the power generation strategy. CSA Prime is not supported by a well-defined federal regulatory framework yet, but such programs are under development now. What OGK-2 plants are you going to include? I am sure about the Surgut SDPP-1 and the Kirishi SDPP, but what about the Krasnoyarsk SDPP-2? Over the last decade, the use factor for installed capacity has been over 50 per cent, and in the first quarter of 2017 it was 72 per cent. High-quality coal reserves are available, the demand and profits are high, but we need an upgrade.

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[1] Led by Russian Energy Minister Alexander Novak, the nationwide meeting "On performance of power generating facilities during autumn/winter period of 2016–2017" took place on April 28, 2017.

[2] The DAM rates are applied according to the Rules for determining the price for capacity traded under capacity supply agreements (approved by the Russian Government Decree No. 238 dated April 13, 2010) and set the capacity prices for gas-fired generating facilities, reflecting the expected proceeds from the sales of electricity.

How much can electricity consumption grow in Russia?

DENIS FYODOROV: It's unlikely that we will see electricity consumption booming at an accelerated pace. A while back, RAO UES predicted an annual growth of 4 per cent. I thought then, and I still think so now, that this figure is considerably overestimated. My opinion is that it will be more or less the same, give or take one per cent. A fairly large increase in consumption can take place in some constituent entities of the Russian Federation, but I don't expect any major advances on the national level – it can be just 1 to 1.5 per cent or 2 per cent at the most. Starting from 2011–2012, electricity consumption has remained steady. I haven't seen any surges, speaking about the Russian Federation at large.

The Krasnoyarsk SDPP-2 is undoubtedly one of our earners. It's a high-profitability power plant and it has two suppliers of coal.

We have already come across challenges at the Troitsk SDPP where the deterioration of the coal-powered infrastructure was so significant that it was basically impossible to repair. This is why we take the technical condition of equipment very seriously and we will certainly invest in the Krasnoyarsk SDPP-2, which is a donor facility for us. Stanislav Ananyev, Director General of OGK-2, can comment in detail on this issue.

STANISLAV ANANYEV: There are two priorities. There is a priority set by OGK-2 – the Surgut and Krasnoyarsk SDPPs are the first in line as the donors. There is also a priority in terms of how we see the possible positions of the Ministry of Energy and the grid operator. Therefore, the Novocherkassk and Stavropol SDPPs should be prioritized from their viewpoint.

We will negotiate our further strategy with the federal executive bodies as part of CSA Prime.

QUESTION: Evgenia Yerykalova, press service of the Troitsk SDPP (OGK-2). The media reported on the possible sale of the Troitsk SDPP to Fortum. Can you comment on this? Do you have an understanding of whether this transaction may happen in the near future?

DENIS FYODOROV: There is a well-known saying: what doesn't sell for money, sells for a lot of money. Therefore, I will reiterate what I said at the meeting of the Energy Ministry. A lot of people are trying to approach us with proposals to buy or to sell something. There are a lot of negotiations we hold routinely. Despite all these discussions, no particular actions are being taken now. So, I can't confirm the sale of the Troitsk SDPP.

As I said at the Energy Ministry meeting, we have recently received a letter stating that Oleg Deripaska (President of RUSAL) wanted to buy out the entire HPP chain on the Vyg River (located in the Republic of Karelia and being part of TGC-1). Earlier, we sold the Onda River HPP, and now they want to take the entire chain. From my standpoint, the rationale I've read doesn't justify selling the HPPs. That's why we reject this proposal and consider it impractical. We also thought it unwise to sell the Onda River HPP, but, due to a number of reasons, we agreed to it.

TGC-1 is well-balanced. It has a well-planned structure with carefully selected facilities and capacities, with both high and low profitability. This is why taking it apart, so to speak, wouldn't be reasonable now. We are well aware that we hold the full responsibility for regional heating, including the regions problematic from the point of view of heat supply systems. Hence, we think that there is no need to interfere with TGC-1's project for sustaining the smelter near the Onda River HPP (Nadvoitsky Aluminum Smelter). Although they had purchased the Onda River HPP, they apparently didn't support the smelter – its aluminum output has dropped significantly. RUSAL has failed to comply with the assigned task. And we don't think it viable to carry out any transactions with TGC-1. I consider it unreasonable to experiment on such Russian constituent entities as Karelia, the Murmansk and Leningrad regions, or St. Petersburg.

QUESTION: Marina Kotsubinskaya, RIA Novosti agency. Are you planning to pay out MOEK's dividends for 2017? The company made a profit in 2016, but the dividends were not paid out.

Have you at least determined a possible selling price for the Troitsk SDPP, if you eventually agree to sell it? Or is it completely impossible, as in the case with the Vyg River HPP chain?

Could you tell us the estimated cost of constructing a gas pipeline to the Novocherkassk SDPP?

DENIS FYODOROV: There is a certain initial estimated cost of gas pipeline construction, determined without taking into account the purchase of land plots – the amount doesn't exceed RUB 1 billion. This is not a random number, but it doesn't take into account any possible contributing factors that may arise during the construction. We are going to engage design institutes in the pipeline project. If we don't see any changes in the coal supply situation, we will probably make this decision.

With respect to the Troitsk SDPP, we don't have any indicative prices at which we could sell it. There are specific valuation methods: the DCF model[3] envisages a substantial sum, given that the power plant includes a new power unit with a capacity of 660 MW. Essentially, the main value driver of the Troitsk SDPP is the new coal-fired power unit – its cash flow is absolutely clear and transparent, based on the reference CAPEX, its use of coal as a fuel, etc. This can always be easily calculated. As I've already mentioned, no withholding is taking place there in the context of non-payments. However, we have not made any valuations.

As for the MOEK dividends, we are not paying out dividends this year and we'll see how it goes next year. Most likely, we will not pay dividends for 2017 either. This is because we have a whole range of projects we are going to deliver for the purpose of improving heat supply reliability in Moscow. It is also related to certain specifics; therefore, we are not planning to pay out dividends for MOEK now. We are making extensive optimization efforts. Compared to the multibillion loss in 2013 (the year MOEK was acquired by the Gazprom Group), we have attained a RUB 900 million revenue as of now. We hope that we will further improve our financial and economic results in 2017. It's only after we ensure sound operating conditions, like those now observed in Mosenergo, TGC-1 and OGK-2, and only after we have a guarantee for three years ahead that no unexpected risks will occur, that we will probably start paying out dividends. We need a year or two to finally get things right.

POLINA STROGANOVA: You've talked about being potentially interested in new projects under the new post-CSA model. In the current environment, are you interested in the competitive selection of generating capacities in new regions, such as Taman, where the conditions have been changed?

DENIS FYODOROV: No, we do not plan to bid in Taman.

POLINA STROGANOVA: It was reported after the Investor Day events that the minority shareholders of Gazprom Energoholding subsidiaries – Fortum and the Moscow Government – are inclined to withdraw from TGC-1 and Mosenergo, respectively. Are you currently negotiating it with them?

DENIS FYODOROV: Our statements at our meetings with analysts are being twisted and misinterpreted in bizarre ways.

We have always said that both Fortum and the Moscow Government can withdraw from the companies under certain economic conditions and prerequisites. These companies are efficiently controlled and we don't see any reasons to pay a lot of money for that at the moment. Of course, discussions take place now and then, but those are not official negotiations, and there is no official stance on the matter. The question was very simple: "Can they withdraw?" My response was: "They probably can." We didn't offer them to sell stock. And I definitely didn't say that we intended to do that or offered anyone to withdraw or sell.

ANASTASIA LYRCHIKOVA: What mechanisms will be adopted by Gazprom Energoholding

[3] Discounted Cash Flow is an investment valuation method based on discounted cash flow analysis.

to boost investments in infrastructure upgrade? What is the content of the talks being underway in the Government and its agencies? Do you expect the mechanism to be developed before the year's end? And what scope of Gazprom Energoholding capacities would you like to propose to upgrade?

It was declared at yesterday's meeting of the governmental Import Substitution Commission that pilot operation of a domestically-produced 110 MW gas turbine will be initiated soon, i.e. this autumn, and that there were prospects for using it in the domestic power industry. How do you assess these prospects? Moreover, a spokesperson for the Ministry of Industry and Trade stated that an investment contract related to this turbine will be signed shortly by Inter RAO, RUSNANO, Gazprom and respective agencies. Could you clarify this information?

DENIS FYODOROV: There was never any question of signing a memorandum with anyone. Several weeks ago, we won a RUB 1.2 billion case in court against the Saturn research and production association with regard to this turbine. If anyone takes an interest in its pilot operation, the turbine is at the Ryazan SDPP now. I didn't speak about it with officials from the Ministry of Industry and Trade. If they need to see the turbine, they may visit the Ryazan SDPP and see what was delivered in December 2016 and then make conclusions about this turbine. Anyway, it seems to me that it's quite easy to make conclusions based on the operating history of six turbines made in Russia.

We spoke about it with Energy Minister Alexander Novak. A number of chief executives from energy companies were invited for a casual meeting to discuss the industry's pressing problems. Almost all the generating companies were unanimous in their position: they are ready to buy domestic equipment – I don't mean the GTE-110 turbine in particular but rather domestically-produced equipment in general – but in order to do so, they need enabling conditions.

The first condition is the abolition of penalties for the failure of domestic equipment that was purchased. The 110 MW turbine featuring a topping (the project for topping a combined cycle gas turbine unit with a gas turbine at the Ryazan SDPP) was put onstream in 2010 – its total operating term is less than a year combined. The turbine was repaired for two and a half years. Just to compare: Siemens supplies a 100 MW turbine within ten months. And we were fixing our turbine for several years.

Inter RAO has simply no choice, they have four turbines. Naturally, they will try to improve their functionality. But the mere fact that they have been refining the turbines since 2008 to no avail speaks for itself. Therefore, the lifting of penalties for the domestic equipment with little operational experience can certainly encourage investments in the purchase of this equipment.

The second condition. The Power Machines plant in St. Petersburg, for instance, has a decent 160 MW turbine. The main problem is that the hot section was not provided by Siemens; it wasn't localized in the Russian Federation. I think that if the upgrading mechanism is finally adopted and applied to a sufficient number of generating capacities, one of the upgrading conditions that may encourage foreign producers to transfer hot section technologies is that Russian products should be fully localized. Especially in the case of 160–180 MW turbines, depending on their type. I don't think that any big secrets or technological difficulties are involved there, as this turbine model has been in production for several decades. There are no obstacles to the manufacturing of hot sections in Russia.

At the same time, I think that there is something wrong with our strategy – we are trying to catch up with someone. The 110 MW turbine was developed more than 20 years ago, if I'm not mistaken. And we are trying to improve the turbine designed 20 years ago. We should set the task of being proactive: to study the relevant foreign projects, to identify their goals and objectives until 2025 and try to develop technologies on the same level, or even more sophisticated ones, instead of attempting to advance the turbine designed 20 years ago. Especially considering that its 110 and 160 MW analogues already exist as I've already mentioned. For all I know, Siemens is ready to manufacture products in Russia. And we know that Inter RAO is producing turbines in Russia jointly with General Electric. In addition,

potential demand needs to be explored. One can't just create a turbine hoping that someone will buy it someday. Demand is key. Alexey Barvinok, Director General of TGC-1, has long been employed with Power Machines and he is confident that more than 10 gas turbines should come onstream each year in order to make it profitable.

I don't know about any memorandums or our participation therein. To my knowledge, Inter RAO is cooperating with RUSNANO and Saturn. But we can't get a well-functioning turbine for the Ryazan SDPP today, not even a single one, although commissioning took place back in 2010. We have two or three years left before the CSAs expire.

As to the scope of upgrades, I can't comment on that. So far, we don't have any clearly defined and comprehensible solutions or proposals. All I can say is that the issue is still under discussion. Besides, the upgrade strategy should be conducted based on the competitive approach. It will not be divided by companies and it will use some competitive techniques we are not aware of yet.

Thus, I can't report either on the extent or the cost of the upgrade. There are two possible options and we favor one over the other.

The first option is to raise the capacity charge in the first pricing zone. And we will assume the commitment to allocate surplus revenues to upgrade equipment, which we believe needs upgrading merely because we know our equipment better and we will better identify our deficiencies and use funds to remedy them. The task is clear.

The second option is like CSA Prime. It provides for establishing certain conditions similar to CSAs. The only difference is that it includes competitive bidding. I am not sure about the conditions, like, if something needs upgrading in Moscow and certain allocations are made, then who will compete with us for the upgrade? I am not very clear on this.

We'll see what decision will be adopted. It seems to me that the best solution is to increase the capacity price in the first pricing zone and transfer some funds to new generating projects. We are witnessing preparations for the construction in Kaliningrad and Taman. Therefore, some of the allocations should be obtained via the CSA and the others via increasing the capacity tariffs to enable generating companies to repair the equipment that is becoming obsolete.

In respect to the current capacity rates, there is nothing to talk about. Today's capacity payment rate refers to 2011, as well as the price in the day-ahead market which hasn't increased dramatically either. The fuel prices and consumer price index are outstripping the electricity and day-ahead market prices. That's why our revenues are not very large. As a result, we don't have incentives for investment. No doubt, we realize our responsibility for the proper operation of our equipment and we channel money in maintenance. But extensive systemic projects, such as the replacement of T-250 turbines in Moscow, need incentives. The project stipulates the replacement of 19 turbines at different points in time before 2025.

We developed the T-290 turbine in cooperation with Renova. The pilot project (for the replacement of the T-25 turbine) was launched at CHPP-22 of Mosenergo. Anyway, we will follow it through regardless of the market situation, because it is crucial for heat supplies to the existing consumers and those we will have in Novaya Moskva. The city administration has built a heating main from CHPP-22 towards Nekrasovka, Lyubertsy, and further on. So, we will finish the project, but a strong impetus is required in order to make it one of many and to place an order for advanced and high-tech products with the Ural Turbine Plant. We think that the lifting of the capacity price will provide such an impetus. And we will assume the obligation to replace deteriorated equipment.

OLGA MYAGCHENKO: Could you give us more details about the physical method? You mentioned it back in 2015. As far as I understand, the transition will begin next year. What extra revenues will TGC-1 receive and how greatly will the costs and tariff for ultimate consumers change?

DENIS FYODOROV: I can't yet comment on the decisions made by the St. Petersburg tariff

authorities. I can only voice the decisions by the Federal Antimonopoly Service that ordered to adopt the physical method. And they should be taken into account.

ALEXEY BARVINOK: We transitioned to the physical method in 2016. And we have been making calculations based on the physical method since. Therefore, according to this method, the follow-up regulatory measures should be taken between 2016 and 2018.

DENIS FYODOROV: As far as I understand the position of the city's administration expressed in the letter to Gazprom's management team, in order to retain the current prices for heat within the tariff frameworks set by the federal executive authorities, extra subsidies in the amount of RUB 2 billion are to be channeled to TGC-1. In my opinion, RUB 2 billion is not a huge amount.

There are two possible ways: either to increase the tariff beyond the limit values determined by the Federal Antimonopoly Service, and this is not a violation, as the Service only issued an instruction on this matter, or to obtain subsidies from the city's administration.

OLGA MYAGCHENKO: But there are no subsidies now, are there?

DENIS FYODOROV: We do not yet know the decision and the way the city's authorities will tackle this situation. It doesn't even make sense to initiate legal proceedings in view of an established court practice. For instance, Fortum was in litigation. It's quite clear how one needs to behave in this case. And it seems to me that no-one expected that, although we had warned others about that several times, and the inquiry by the Federal Antimonopoly Service took a while. So, we do not quite understand why people are so surprised.

My point is that amending the budget and paying RUB 2 billion is the most appropriate and objective approach. Moreover, the amount has been calculated by the city authorities.

OLGA KVASHINA: Are any new facilities being constructed under the import substitution program? Is there a possibility of setting up branch offices in such single-industry towns as Zelenogorsk to boost electricity and heat consumption?

DENIS FYODOROV: There is nothing I can say about towns like Zelenogorsk. We have a factory to produce our own controllers for the Automated Process Control system (TEKON Group). Now, we are producing modern domestic burners and last year we launched the output of relay-protective automation (RPA) that met international standards, and prior to that only foreign burners had been used. By now, we have used the domestic RPA for the first time at Power Plant No. 1 (Central CHPP of TGC-1). Gazprom Energoholding holds a 25 per cent stake in this company (TEKON Group).

We don't intend to handle everything and to replace all imported goods by domestic equivalents. We can select the projects that we can really deliver and we see our needs for several years ahead with respect to certain types of products. And we assess our capabilities. We started to produce membranes and we have a positive experience of their application at our own plants for chemical water purification. We regularly replace these membranes.

Moreover, if we touch upon the matters of import substitution or establishing high-tech manufactures, we will see that the situation is as follows. Everyone is saying: "Let's make turbines." We say: "Dear colleagues, it's not the turbines, it's the turbine blades that should be put into mass production these days." Today's business is mainly about servicing, which means the provision of blades. If you produce blades in Russia, we will enter into contracts with you. My vision is that the scopes of servicing contracts will soon prevail over the scopes of purchased equipment, the scopes of gas turbines, in terms of their price. So, let's make the blades first and then complete the gas turbines, if we can.

Just to inform potential investors: we have enough space at our power plants, we have heat, water and, at some plants, we have gas. We are ready to offer our potential investors the most comfortable working conditions.

MODERATOR: Thank you. The Press Conference is over.