

GAZPROM'S POWER GENERATION STRATEGY

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Gazprom Group is the leader of the Russian power market in terms of the aggregate installed electric (some 38 GW) and thermal (over 70 thousand Gcal/h) capacity. Participation in power generating companies increases Gazprom's competitive ability and provides for higher operational flexibility as well as allows the Group to manufacture products with a higher added value.

The Group's major power generating assets are consolidated in Gazprom Energoholding, Gazprom's wholly-owned subsidiary which is the majority shareholder of Mosenergo, TGC-1, OGK-2 and MOEK.

In 2013 Gazprom Group strongly established its strategic leadership position in the Russian power generation sector. Just as in the previous years, the Group kept on implementing investment projects while staying focused on reliable power and heat supply to consumers, as well as took a number of measures enabling to reduce costs, strengthen the financial position and improve the management mechanisms in its power generating companies.

In 2013 the main companies of the Group (Mosenergo, TGC-1 and OGK-2 excluding MOEK) produced 158.6 billion kWh of electricity (5 per cent down compared to 2012) and 99.7 million Gcal of heat (1.4 per cent down). The main reasons for lower power output are the decrease in generation caused by a lighter load on inefficient power units as well as a slump in electric power demand. Heat generation rates were affected by warm weather.

The total 2013 proceeds (Mosenergo, TGC-1, OGK-2 results under the IFRS) amounted to RUB 338.6 billion (4.6 per cent up), EBITDA – RUB 51.7 billion (11.7 per cent up) and net profit – RUB 18 billion (15.4 per cent up).

2013 was marked by a milestone event – Moscow United Energy Company (MOEK), the leading infrastructure company of the Russian capital city, supplying heat and hot water to Moscow and several Moscow suburbs, joined Gazprom Group. The deal on acquisition of 89.98 per cent in MOEK (as well as movable and immovable assets technically connected to the Moscow heat complex leased by MOEK from the Moscow City Government) by Gazprom Energoholding was closed in September 2013. Following the formal offer forwarded to the minority shareholders of MOEK, starting from January 28, 2014 the share of Gazprom Energoholding in the company's equity capital increased from 89.98 to 90.048 per cent. In addition, 8.91 per cent of MOEK shares are owned by its wholly-owned subsidiary MOEK-Finance.

On acquiring MOEK, Gazprom became the leader in terms of installed thermal capacity in Russia.

MOEK's shares and assets will contribute to reaching synergies in reducing fuel costs, switching the loads of MOEK boiler houses to Mosenergo power plants as well as managing the Moscow heat supply system more efficiently.

Gazprom Group's investment program is one of the major ones in the Russian power industry. The Group's generating companies implement the investment program, taking into account their obligations under capacity supply agreements (CSA). This secures a substantial cash flow from selling electric power and capacity of new power generating units. As a result of the CSA program execution by Gazprom's companies, the new capacity buildup in Russia will amount to some 9 GW (57 per cent of these capacities were put onstream as of December 31, 2013) from 2007 to 2017.

In 2013 the Group commissioned 420 MW of new generating capacity in Russia:

- the Adler TPP (OGK-2) – two PGU-180 power units with the aggregate capacity of 360 MW;
- hydro power unit No. 5 at the Lesogorsk HPP (TGC-1) with the capacity of 29.5 MW;
- hydro power unit No. 12 at the Svetogorsk HPP (TGC-1) with the capacity of 30.5 MW.

The state-of-the-art Adler TPP was the main power and heat supplier to the basic infrastructure facilities of the XXII Winter Olympic Games and XI Winter Paralympic Games in Sochi in February 2014. Upon commissioning of two hydro power units, TGC-1 completed the large-scale reconstruction of the Vuoksa HPP Cascade – a major source of electric power on the Karelian Isthmus.

In addition, in 2013 a heat pipeline was constructed from the Apatity CHPP to Kirovsk in the Murmansk Region. It is a socially important investment project aimed at increasing the quality and reliability of heat supply and reducing the share of costly oil-powered generation.

In 2013 Gazprom delivered one of the biggest gas energy projects in Armenia – the Company launched the commercial operation of the fifth power generating unit at the Hrazdan TPP (480 MW) and thereby relieved the power shortage in Armenia.

Last year Gazprom Group started a new project for constructing power generating facilities abroad. In September 2013 Gazprom Energoholding and NIS (part of Gazprom Group) inked the memorandum to build a 208 MW thermal power plant (TPP) in the Serbian town of Pancevo. The power generated by the TPP will, above all, meet the needs of the NIS-owned oil refinery and the HIP Petrochemija petrochemical plant – a strategic partner of NIS. The plant is scheduled for commissioning in 2017.

Gazprom Group regularly monitors the markets that can be attractive for the power generating business. In particular, nowadays the Company is looking into European (Germany and Balkan States) and Asian (Japan, China and Vietnam) markets.

Gazprom Group develops its power generating business by giving priority to stronger operational efficiency of its power generating assets. Gazprom's domestic generating companies are running the following cost optimization programs and actions aimed at improving the financial indicators:

- Cost-Saving Production Strategy;
- programs for value enhancement for shareholders;
- streamlining reconstruction and upgrade programs;
- streamlining maintenance and investment programs;
- optimizing load modes and fuel balances;
- improving the procurement strategy;
- restructuring subdivisions.

These activities provided the companies (Mosenergo, TGC-1 and OGK-2) with RUB 4.1 billion of EBITDA gain in 2013, and their effect is projected to produce more than RUB 2 billion in 2014.

Power generating companies of Gazprom Group seek for new ways of growth and entry into new market segments. Thus, in 2013 Mosenergo launched a project with the Moscow City Government for constructing electric vehicles (EV) charging stations. The agreement has been signed and it was agreed to promote electric vehicles and create the necessary infrastructure in Moscow.

At 2014 year-end the total power generated by the Group's three companies is expected to make up 167.5 billion kWh (5.6 per cent up compared to power generated in 2013) of electricity, and 101.6 million Gcal (2 per cent up) of heat. According to the IFRS, total revenues are expected to be RUB 354 billion (4.5 per cent up), EBITDA — RUB 53.7 billion (3.8 per cent up).

The Company is currently working out a development program for MOEK and studying its forecast performance indicators.