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Key rating assessment
factors

ACRA assigns AAA(RU) to PJSC “GAZPROM”, outlook Stable

The credit rating assigned to [PJSC “GAZPROM”](#) (hereinafter, Gazprom, the Company, or the Group) is based on very high systemic importance of the entity for the Russian economy and high level of state influence according to the ACRA methodology. Standalone creditworthiness of the Company is determined by very strong business profile, low industry risk and strong financial profile. The medium leverage and debt servicing indicators as well as weak free cash flow indicators driven by substantial capital expenditures and dividend payouts have a restraining effect on the standalone creditworthiness assessment (SCA).

Gazprom is one of the largest integrated energy companies globally. Gazprom’s share in the global gas production is 11%, and 66% in the total domestic output. The Group is one of the largest oil producers in Russia (through [Gazprom Neft PJSC, AAA\(RU\), Stable](#)). Gazprom owns large power generation assets (through Gazprom Energoholding). The Company also owns a gas pipeline network of total length of 171,000 km.

Gazprom constitutes an integral part of the national economy. The Company has a status of the sole pipeline gas exporter in the Russian Federation; it is one of the largest taxpayers and revenues sources for the federal budget. Gazprom performs social functions by acting as a large employer and implementing the gasification program and other socially focused projects in the Russian regions, and is critically important for the country’s energy security. These factors determine the systemic importance of Gazprom and state influence as very high.

Very strong business profile is based on low production costs and high sufficiency of the resource base. Gazprom’s proved PRMS reserves stood as at December 31, 2016 as follows: 132.69 billion barrels of oil equivalent, of which 23,855 billion cubic meters of natural gas, 1 019 million tons of gas condensate, and 1,379 million tons of crude oil. The Company produced 420.1 billion cubic meters of natural and associated gas, 15.9 million tons of gas condensate, and 47.2 million tons of crude oil in 2016. Output grew in 2017 in both natural gas (by 12% vs 2016) and liquid hydrocarbons (+7% for 9 months of 2017 year-on-year) by virtue of increased production in oil fields of Gazprom Neft PJSC.

Very high operational profile is supported by very high market accessibility and diversification. Natural gas exports to countries outside the former Soviet Union increased by 8% in 2017 totaling record 193.9 billion cubic meters. ACRA expects that the Company would increase its natural gas exports to countries outside the former Soviet Union to 204 billion cubic meters by 2020 owing to higher demand in Europe on the back of declining coal and nuclear generation capacity as well as lower output in the North Sea. In addition, ACRA takes into account the continuing gain in importance of renewable sources in the EU energy mix as well as further strengthening energy efficiency as part of 2030 objectives as set forth by Renewable Energy Directive of the European Commission. This directive stipulates reduction of CO2 emissions by 40%, increase of power generation from renewables by at least 27% (which involves an increase of share of renewables in power generation to 46%-49%) and improvement of energy efficiency in the economy by 27%.

The Agency projects that gas exports to China over the Power of Siberia pipeline would commence as planned in December 2019, while the average return on sales to China would be comparable to that of European exports.

Medium leverage and very strong liquidity. Substantial needs of the Company in financing its capital development program resulted in higher adjusted debt to FFO before net interest payments from 1.4x in 2014 to 2.1x in 2016.

According to ACRA's projections, the Group's investment spending (including investments into joint venture projects) would amount to RUB 1.58 trillion and RUB 1.51 trillion in 2018 and 2019, respectively, and would decline to RUB 1.3 trillion in 2020 following completion of large infrastructure projects (Power of Siberia, North Stream 2, and TurkStream). ACRA also projects that adjusted debt to FFO before interest payments would stand at 2.5x and 2.3 in 2017 and 2018, respectively, and return to 2.1x by 2019.

When assessing liquidity, ACRA takes into account the ample capabilities of the Company in raising financing in the Russian and international markets.

High profit margins are supported by low production costs (RUB 1,998 per 1,000 cubic meters), with the mineral extraction tax (MET) accounting for around 55% of the above figure. MET rate increase and the export pricing mechanisms for natural gas (the time lag between gas price increase and crude oil price growth, which drives simultaneous appreciation of the ruble exchange rate) were among the key factors for the decline of the FFO margin before interest and tax from 38.3% in 2014 to 24.4% in 2016. Lower profit margins were also due to trading operations restructuring in Europe and higher trading volume. ACRA expects the FFO margin before interest and tax to remain at 24%-26% in the forecast period.

Negative free cash flow is determined by a substantial amount of capital investments and by maintaining the Company's dividend payouts at the current level. ACRA projects the FCF margin after dividend payouts to be negative (in the range of -5% to -2%) in 2018-2019 and return to the positive values by 2020.

Key assumptions

- Retaining the status of the sole exporter of pipeline gas in the Russian Federation;
- The average annual USD/RUB exchange rate of 59.1 in 2018, 60.3 in 2019, and 61.5 in 2020;
- The average annual Brent crude oil price is USD 58/barrel in 2018 followed by an increase to USD 60.9/barrel By 2020;
- The average annual gas export price in the European market rises to USD 244 per thousand cubic meters by 2020;
- Domestic natural gas prices would increase by 3.4% in 2018, by 3.1% in 2019, and by 3% in 2020;
- 4% inflation, 3% annual indexation of electricity rates and 2% annual indexation of gas transportation rates for independent producers in 2018-2020;
- Natural gas MET cuts from RUB 1,098 per thousand of cubic meters in 2017 to RUB 748 per thousand cubic meters in 2018 and RUB 769 per thousand cubic meters in 2019-2020;
- No changes in crude oil production taxation (including the additional summand in the crude oil MET rate formula of RUB 357/t in 2018 and RUB 428/t in 2019-2020);
- Annual dividend payouts of RUB 190 bln in 2018-2020.

Potential outlook or rating change factors

The **Stable outlook** assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

A negative rating action may be prompted by:

- A significant decline of the Company's systemic importance for the Russian economy;
- Loss of the state's control or a substantial change of the industry legislation.

The rating of PJSC "GAZPROM" is at the highest possible level under the national scale, and therefore, no factors prompting a positive rating action are determined.

Rating components**Standalone creditworthiness assessment (SCA):** aa.**Support:** on par with the Russian Federation.**Issue ratings**

No outstanding issues have been rated.

Regulatory disclosure

The credit rating has been assigned under the national scale for the Russian Federation and is based on [Methodology for Credit Ratings Assignment to Non-Financial Corporations under the National Scale for the Russian Federation](#), [Methodology for Analyzing Relationships Between Rated Entities and the State](#) as well as [Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#).

A credit rating has been assigned to PJSC "GAZPROM" for the first time. The credit rating and its outlook are expected to be revised within one year following the rating action date (January 31, 2018).

The assigned credit rating is based on the data provided by PJSC "GAZPROM", information from publicly available sources, as well as ACRA's own databases. The credit rating is solicited, and PJSC "GAZPROM" participated in its assignment.

No material discrepancies between the provided data and the data officially disclosed by PJSC "GAZPROM" in its financial statements have been discovered.

ACRA provided no additional services to PJSC "GAZPROM". No conflicts of interest were discovered in the course of credit rating assignment.

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