

Press Conference
Gazprom's Financial and Economic Policy
June 25, 2015

MODERATOR: Hello, colleagues. Today we are finishing a series of Press Conferences held prior to the Shareholders Meeting. And by tradition, the last Press Conference is dedicated to the Financial and Economic Policy of Gazprom.

Participating in the Press Conference are: Andrey Kruglov, Deputy Chairman of the Management Committee, Department Head (in charge of Finance and Economics); Elena Vasilieva, Deputy Chairwoman of the Management Committee, Chief Accountant; Elena Karpel, Department Head (Economic Expert Analysis and Pricing); Karen Oganyan, Department Head (Tax Policy); Mikhail Rosseev, Deputy Chief Accountant.

I'm giving the floor to Mr. Kruglov now. Then we'll pass on to your questions.

ANDREY KRUGLOV: Good morning, dear friends. There are not too many of us today, so, I guess, we'll have the opportunity to communicate and you'll be able to address your questions to all the conferees. May be we'll ask you some questions too. May be you'll be even surprised by some data from our presentation. At the same time, I see that some tiredness is felt: our briefing completes this series of Press Conferences.

(Slide 1) Before we start, I would like to traditionally draw your attention to this so-called disclaimer. Although English loanwords are not very popular in our country, but still I would like to say once again that most of the data we are going to discuss represents predictions by all means. And until any relevant corporative decisions are taken by the Management Committee and the Board of Directors, this data surely may not be perceived as an official position of the Company – only as a forecast.

(Slide 2) Let us start. Although both Russia and our Company are under the pressure of sanctions, and oil prices are falling, Gazprom delivered sound financial results at the end of 2014. One of the most important indicators – EBIDTA – came to USD 52 billion in equivalent. By this indicator Gazprom entered the top five public companies and the top three public oil and gas companies worldwide. Over the last five years Gazprom has annually been among the world's top five companies by key financial indicators.

Before we move to the next slide I would like to address a question to you. What do you think, have the sanctions and anti-Russian sentiments in Europe affected our cash flow?

REMARK FROM AUDIENCE: Well, the sanctions were not imposed on Gazprom.

ANDREY KRUGLOV: The answer is correct. Yet, the general sentiment is present.

(Slide 3) Now, let us move to the next slide. Over the last nine years we have been generating positive free cash flow. At the same time, for nine quarters in a row Gazprom has been generating positive cash flow even in the conditions of extremely intense seasonality of business. And this year we set a record – RUB 654 billion or USD 17 billion of free cash flow – and took the lead among the world's public gas and oil companies by this indicator. Hence, as it is said, in spite of everything, our caravan steers a stable course.

(Slide 4) Surely, such factors as efficiency, profitability and other indicators are significant, but for a joint stock company it is really important how much a shareholder could receive as a return on investment in the company's shares.

The issue of shareholder value is, by all means, one of our main priorities. Based on last year's operations the Management Committee resolved to allocate as dividends 90 per cent of the Company's net profit under the Russian accounting system or 107 per cent of the consolidated net profit under the IFRS. There have been a lot of questions about when dividends will be calculated under the IFRS. As you can see, there is no big difference this year actually. The Management Committee sticks to the line of maintaining the size of dividends, at least, at the level of previous periods and advocates for this line before its shareholders.

And if the size of dividends is approved at tomorrow's Shareholders Meeting, the dividend yield of the Company's shares for 2014 will meet and somewhere even surpass the level of the leading global energy companies.

(Slide 5) Yes, it is becoming harder for us to operate in the domestic market. In particular, independent producers are building up their activities. However, in order to accelerate the process of matching the competitive conditions for all gas suppliers and increasing the sales efficiency in the domestic market, the Russian Government is considering the transition to price regulation by setting a price range with a discount up to 15 per cent without regional differentiation. If taken, this decision will let Gazprom pursue a flexible gas price policy for industrial consumers and households, as well as at least partially resume the compensation of losses from gas sales at relatively low prices to subsidized regions.

(Slide 6) Following ruble devaluation the diagrams look quite interesting. Please note: the difference between gas prices in Russia and European countries as well as in the USA is particularly evident at the level of end consumers. Very often some officials appearing on television compare our gas prices with those in the USA and Europe. We expect that the gap between gas prices in Russia and international markets will gradually shrink sticking to the principle of equal-netback pricing as a long-term target.

(Slide 7) The situation with gas transmission tariffs is still not that optimistic. Presently the tariffs for gas transmission services in Russia are lower than in Europe and the USA to a large extent. In 2014, as a result of tariff freezing, the gas transmission profitability of independent producers became negative for Gazprom decreasing to -2.4 per cent.

The tariff increase by 2 per cent from July 2015, as proposed by the Russian Federal Tariff Service, won't make the gas transmission services profitable: of course, the unprofitability will become somewhat lower, but at the same time it will still be at a level of -2.2 per cent. We believe that it is necessary to adjust the approaches maintained by the FTS to setting the gas transmission tariffs for the purpose of more economically fair pricing.

(Slide 8) An important event for Gazprom was the resolution of the Russian Government to start calculating the severance tax for gas based on a formula starting from July 1, 2014. The new method of gas tax calculation fixes the dependence of tax rates from average gas sale prices, provides tax benefits for new, mature and challenging fields, improves the taxation transparency and stability for gas producers, and sets transparent rules of gas condensate taxation.

It is important that by contrast to the oil sector, where a system of tax reliefs for individual groups of projects has long been a common practice, the new severance tax calculation rules introduced benefits for gas producers for the first time.

(Slide 9) And finally our core data on the financial strategy. In the conditions of instability and declining oil and gas prices it is necessary to follow a conservative financial strategy, which we, by the way, have always pursued, and which has let us secure the Company's financial sustainability. This strategy still enables us to timely respond to a possible deterioration of the market situation and challenges.

Given the current environment, the key areas for the optimization of our Company's activities include: building a conservative budget with account of doubtful income, further optimizing expenses, identifying priority projects in the investment program, managing the floating capital, expanding the centralized liquidity management system, effectively managing debts and managing financial risks.

(Slide 10) Surely, expenses are also an issue of special attention for the Company's top management. We are making efforts to keep costs down. In 2014 the total effect of Gazprom's Cost Reduction Program was RUB 21.8 billion. In 2015 such effect is projected at RUB 13.1 billion.

Gazprom's gas production cost is one of the lowest in the world. In 2014, considering gas treatment expenses, this cost reached RUB 1,435 per 1,000 cubic meters of marketable gas or less than USD 38 per 1,000 cubic meters, including the severance tax. According to our estimates, in 2015 gas production will be priced at less than USD 30 for 1,000 cubic meters.

(Slide 11) Implementing metal-intensive projects, we pay special attention to the optimization of the vital materials and equipment pricing. In 2014 over RUB 20 billion was saved in our purchases of vital materials and equipment. The pipe product prices were set in 2014 using a formula, which is applicable in the same way as the formula for gas supplies to Europe with a time lag of around six months. It enabled us to increase the price transparency, fairly distribute the risks from price changes among producers and consumers as well as implement competitive procedures.

(Slide 12) In compliance with the Russian President's assignment and the Russian Government's directives, a single treasury of Gazprom Group has been established. Its main aim is to centralize the management of intra-Group cash flows, covering eventually all of the Group's subsidiaries both in Russia and abroad. In addition to the pools operating in Germany and the UK, work is underway to transfer a group of Gazprom's Dutch companies from the nominal to the physical pool. A physical pool was also launched in Russia at a platform of Gazprombank. By now, 18 Russian subsidiaries have already been connected to that pool.

The concentration of the Group's funds at the parent company's accounts will allow us to use our internal financial reserves with maximum efficiency. This is especially important in the conditions of, frankly speaking, limited access to financial markets.

(Slide 13) Now let's get back to the maximization of the Company's shareholder value: in 2014 we included three new KPI into the remuneration system for the Company's top managers. Starting from 2015, 30 per cent of the top management's bonuses are determined by the key financial and market indicators: return on equity capital and shareholder investment profitability.

(Slide 14) Please draw your attention to this diagram. As you can see in the slide, over the last nine years the Company's capital investments have been fully covered by the operational cash flow.

There is strict prioritization of projects and subsequent monitoring of their implementation efficiency. From 2011 we see a strong downward trend in capital investments in US dollars.

In the case of a negative market development trend, projects having low priority for the Company's strategy and having no direct impact on the gas balance might be revised in the first instance. Of course, it is early to speak about this situation at the moment. However, in our activities we analyze all cases, including possible and even unlikely ones.

So, Gazprom's investment program envisages certain flexibility for the worst market development case.

At present, Gazprom's investment program planned for 2015 is being implemented in full. It amounts to RUB 1,600 billion. Please note that this is the entire investment program including not only capital investments but also long-term financial investments.

(Slide 15) Every year the Company settles more debts than borrows. In 2014 Gazprom Group's total debt decreased by over 13 per cent – from USD 55 to 48 billion. Thanks to the refinancing of borrowings with high interest rates we managed to additionally reduce the debt value. In 2014 the net debt to EBITDA ratio in US dollars was 0.6. Throughout 2014 debt ratios were considerably lower than our internal limitations.

It has been fairly noted at the beginning of our discussion that Gazprom is not under financial sanctions and is able attract finance in international markets. This is confirmed by a number of recent transactions including Eurobond placement in the fourth quarter of 2014 and several capital raising transactions with international banks since the beginning of 2015.

This February Gazprom was the first Russian company to receive the highest credit rating – AAA – from China's Dagong rating agency. The ratings and forecasts of Standard & Poors, Moody's and Fitch remain at the level of the sovereign rating of the Russian Federation. We believe that we have something to work on with our colleagues from these rating agencies: particularly we'd like to discuss their methodologies, how adequately they reflect the actual financial situation. Nevertheless, we keep working with these agencies.

(Slide 16) Taking into account a serious depreciation of the ruble, it is worth mentioning that Gazprom is characterized by a high degree of immunity to a reduction of national currency value. Around two thirds of the Company's receipts are denominated in foreign currency, mainly in US dollars and euros, or are linked to it. The share of operational costs and capital investments dependent on foreign currency rates is significantly lower and averages 42 and 21 per cent respectively.

Consequently, due to a weakening of the ruble, the growth of export revenues surpasses in ruble terms the growth of operational costs and capital investments. It has a positive effect on the Company's profitability and ruble-nominated cash flow.

As for the foreign currency component in Gazprom's debt structure, its share correlates with the prevailing foreign currency component in the revenue structure, and this reduces currency risks. In such a way, the foreign exchange debt revaluation has no negative effect on the Company's ability to service its obligations.

(Slide 17) We have started our communication from the question about to what extent the sanctions influence our Company's performance. Certainly, they do, but at the same time, in November 2014, amid the developing crisis which was at its peak at that time, we issued and placed Eurobonds worth USD 700 million. Despite the complex geopolitical situation, the Eurobond placement was secured by our key investors from the USA and UK.

Over the past 12 months Gazprom has raised more than USD 2.5 billion through credits and bonds at interest rates below Gazprom Group's average debt value. By the way, an average interest rate on Gazprom's loans has been continually declining since 2011. And just recently a new four-year EUR 300 million facility agreement has been signed with Unicredit at the St. Petersburg International Economic Forum. The sanctions mainly affected our documents, while the capacity to attract funds is intact.

(Slide 18) Gazprom performs a big scope of work to diversify its finance sources, including in the countries of Asia-Pacific. Among possible tools of raising capital in the region are syndicated loans, project financing and issues of bonds nominated in Asian currencies. Besides, we are active in furthering our cooperation with Asian investors and bank representatives.

In June 2014 the Company got listed on the Singapore Exchange. At present, Gazprom is studying possibilities to expand its presence at the key exchange platforms of Asia-Pacific, including to increase the level of global depository receipts listing on the Singapore Exchange and have a listing on the Hong Kong Exchange.

In February Gazprom for the first time held its annual Investor Day in Hong Kong and Singapore. The event aroused big interest among the regional and international investors. And I have already spoken about the rating of China's Dagong independent agency.

(Slide 19) So, despite the unfavorable external environment Gazprom keeps successfully implementing its financial strategy aimed at shareholder value maximization. In 2014 the Company achieved a record high free cash flow, maintained dividend payouts at a high level and continued to diversify its relations with partners towards Asia-Pacific.

I guess, I'm done with my brief overview, dear ladies and gentlemen. Now let us move on to the Q&A session.

QUESTION: Sofia Dvornik, RIA Novosti agency. Hello. My question is related to capital raising in Asia, namely from Asian banks. When can we expect such deals to happen? Do you consider such an option?

ANDREY KRUGLOV: As for our collaboration with financial institutions from Asia-Pacific, or with "Asian banks", as you've said, we have recently signed a facility agreement with two Japanese banks, namely SMBC (Sumitomo Mitsui Banking Corporation) and Mizuho. It was two months ago. I mean, this work continues. Yet, we already had a positive experience of cooperating with these banks.

As for Chinese banks, we are working on this as well. The main issue here is some kind of inertia. We haven't established active ties and relations or gained project experience in the financial sphere yet. That's why negotiations and document discussions take quite a lot of time. Formal work, so to say. In fact, everybody is generally ready for cooperation. All we have to do is to agree on the terms, conditions and wording acceptable to both parties. And I hope we'll finalize this work soon.

QUESTION: Maria Vlasova, Interfax agency. Why has Gazprom created a 100 per cent reserve under guarantee for Ostchem? Does it realize its liability for the loan?

In 2014 Gazprom Engineering, Temryukmortrans, Gazprom Invest Vostok, and GES Surgut left the Consolidated Taxpayer Group. We wish to know the reasoning behind the exclusion of these companies from the Group. Some of them apparently are awaiting dissolution. And others perhaps are preparing to be sold. If so, which of them?

ANDREY KRUGLOV: The question regarding Ostchem will be answered by my colleagues from the accounting unit. I will start answering the second question and Karen Oganyan will speak further about the Consolidated Taxpayer Group.

As for the reasoning behind the exclusion of the mentioned companies, it is not necessarily connected with their dissolution. As you know, companies join the Consolidated Taxpayer Group, if, for instance, they have a certain amount of transactions under control. If this amount decreases, companies can make a decision to leave the Consolidated Taxpayer Group.

In fact, it is not necessarily connected with dissolution or sale. And I want to inform you that there are no plans to sell these companies. It has a technical background, namely the amount of their transactions under control.

KAREN OGANYAN: Mr. Kruglov has largely answered the question. There is one more thing I can add. The Consolidated Taxpayer Group is primarily a voluntary association of income taxpayers. It is a way to pay the income tax.

Moreover, the legislation provides certain criteria for membership in the Group for different organizations, including quantitative criteria. If some organizations fail to comply with these criteria prescribed by the legislation, we have to ensure that these companies leave the Consolidated Taxpayer Group.

Beside the fact that this Group includes, as Mr. Kruglov has said, organizations according to the amount of transactions under control, there is another factor: compliance with the criteria set by the legislation. If a company is no longer compliant with these criteria, we exclude it from the Group in order to meet the requirements of the legislation. That's it.

ANDREY KRUGLOV: Chief Accountant Elena Vasilieva will respond to the question regarding Ostchem.

ELENA VASILIEVA: In December 2014 the Group issued a guarantee to Gazprombank for the debt of Ostchem Holding Ltd. to secure its loan. As at December 31, 2014 it amounted to USD 843 million. The decision to create a reserve for the loan was made by the subsidiary company of the Group itself. But it is still possible to settle all questions.

QUESTION: Elena Mazneva, Bloomberg agency. Hello. Please, clarify. Is it possible to make forecasts on the main financial indicators for this year, either in dollars, rubles, or other currency, taking into consideration the declining prices in Europe? What is Gazprom Group's total revenue, for instance, under the IFRS: total EBITDA and total profit?

The second question relates to the scheduled Eurobond placement this year. At the St. Petersburg Forum you said, that basically there were no such plans. However, later Gazprombank said that

it was planning to issue RMB-nominated bonds. So, what does this issue plan mean? Shall we expect it to happen this autumn? Or is the issue now under preparation to be placed next spring? And the third question is certainly about financing plans for all gas export pipeline projects scheduled for implementation by Gazprom. They are two gas pipelines to China, Nord Stream 2, and TurkStream. Implementation of these two projects falls almost within the same time span. This implies that all money must be spent until 2019–2020. How much money will Gazprom allocate (without project funding)? Won't Gazprom's other projects and dividends be affected in view of these large-scale projects?

ANDREY KRUGLOV: Concerning the latter, no, they won't. We hope it won't damage the dividends. So, other projects won't suffer for sure. Speaking about the dividends, it depends not only on the management's position, but also on the position of the shareholders. They make eventually a decision on dividends. As for the position of the Company's management, the Management Committee, I've said already that we are committed to keeping dividends at least at the same level of previous periods. We hope to maintain this line on the way forward.

As for financial indicators at the end of the year, it is too early to speak about it given that we haven't closed officially the first half of the year. It is difficult to provide forecasts before autumn comes. By the way, at the Forum I told you almost everything I knew, so I'm just repeating.

Let's take, for instance, the adjustments to the investment program. No wonder that we adopt it basing on the results of the half of the year. Before we consolidate the data, we should close the half of the year and process the data. It might be in September or October, when we can give you preliminary figures and provide forecasts on revenue, EBITDA and other indicators.

As for the construction of gas pipelines, most of it Gazprom plans to implement at its own expense. However, you are well aware, that we have an experience in constructing large-scale international transmission gas pipelines using project financing methods. And this experience has always been positive, whether it be the Nord Stream project or the Blue Stream project.

Even today I have no doubts that using project financing methods we will manage to implement the international part of this project, i.e. its offshore parts which are to be built in the sea and for which specific project companies were established, as it was in case of the Nord Stream project.

As for bonds, we'll see. Perhaps, we'll do it this autumn. I am not sure, whether they will be RMB-nominated. In fact, it is expensive to do it in Asia. This market historically has higher rates compared to the European market or dollar market. We'll follow the market situation. Anyway, we won't place bonds at high rates.

ELENA MAZNEVA: What is your assessment of all export routes, two pipelines to China, TurkStream and Nord Stream 2? It appears that Gazprom's internal funds will amount to USD 75–80 billion over five years, taking into consideration two fields – Kovyktinskoye and Chayandinskoye. In other words, 55 + 15 + part of the TurkStream project, which I think will be at least 10. It should be like that, right?

ANDREY KRUGLOV: In fact, we haven't got any figures yet. We haven't yet estimated costs either for Nord Stream or for TurkStream. In general, regarding the gas pipelines, we can speak only about two of them, namely to China, though on a preliminary basis. In fact, we can speak only about one route as the agreement on the western route hasn't been signed yet. However, we hope to have it signed in the near future as it was said before. That's why general preliminary figures are perhaps more or less in line with real ones.

QUESTION: Vitaly Sokolov, Energy Intelligence. Hello. My question is also about money. At what rate did Gazprom take out the latest loan from Unicredit? Does Gazprom plan to take out other loans in Europe and at what rate? How have the sanctions influenced the borrowing costs?

ANDREY KRUGLOV: In my presentation I've said that the rate of loans received on average corresponded to Gazprom's placement rates. Let me reiterate, our borrowing costs have been reducing since 2011. In particular, we have attracted loan funds from Unicredit at a rate lower than 4 per cent for four years.

In general, speaking about the rates, there is a market and we cannot ignore it. However, we can assess objectively its impact on us. Let's take bonds, as we've just started speaking about them. At the Forum there were questions about bonds as well. I don't think that the current level of debt assessed is adequate. But the situation may possibly change.

You know, when we placed a bond in November, it was a one-year bond and the rate was over 4 per cent. At that time everyone also argued that it was expensive. However, a month later the same bond cost 6 per cent in the market. Was it expensive or not? Sometime later, in December, the rate was even 9 per cent!

That's why I strongly believe, that it was a good bond issue. I am sure, you remember, that there was such a tense situation in the world, and so much negative, even belligerent rhetoric from foreign countries against the Russian Federation. Nevertheless, we proved that we are able to operate in the international financial markets not only at adequate but favorable rates. And we will continue to do so.

According to the financial plans, our loan program is RUB 90 billion this year. And this program has been almost completed.

QUESTION: Denis Pinchuk, Reuters agency. Mr. Kruglov, please correct me if I am wrong. I understood you to say, that you are to make a project finance transaction for the first string of TurkStream. Is that right? If yes, do you plan to do it in the coming months or this year? With which partners and in what amount approximately?

ANDREY KRUGLOV: It is hard for me to give a definitive answer to this question right now. As you know, just recently we have received a permit to carry out surveys within the territorial waters of Turkey.

In fact, project financing is to involve a project company, which hasn't been established yet. We haven't yet chosen our partners. In order to say whether it will be project financing or self-financing, it is necessary to fulfill a number of conditions: to establish a project company, to choose partners, it could be Gazprom as well, to define a legal form of the project company, to set a tariff for gas pumping via this gas pipeline ensuring that it covers investment costs. Only after that one may say whether this project will be implemented with project financing or self-financing. In fact, we have sufficient funds to cover costs of the first string.

DENIS PINCHUK: How much does the first string cost?

ANDREY KRUGLOV: I cannot answer this question as we are just investigating the Turkish bottom in the Black Sea.

ELENA MAZNEVA: Have you started construction work yet?

ANDREY KRUGLOV: We haven't started construction in that place. We've started from the side of the Russian Federation, from the Russian bottom of the Black Sea.

QUESTION: Simon Pirani, Gas Matters magazine. My question is about domestic gas sales. Your presentation points out that transition to a new regulation is currently under consideration of the Government. Last year you said the same. Why the decision-making process is so slow?

And one more question. What are your projections on the revenue for this and next year?

ANDREY KRUGLOV: I've already spoken about the revenues. It is too early to give any projections. Perhaps, in autumn. As the phrase goes, don't count your chickens before they are hatched. I guess, we will be able to give some projections, some indicative figures, but in autumn.

I am also wondering why it has been taking so much time to make a decision. Let me yield the floor to Elena Karpel, who will provide more detailed comments on your question.

ELENA KARPEL: For the gas market development purposes a number of proposals have been prepared on establishing a discount mechanism for large gas consumers as well as draft amendments have been developed to the main provisions on the governmental regulation of gas prices, as approved by Governmental Decree No. 1021.

The discussion on this issue has been taking much time. It resulted in proposals submitted by the Federal Tariff Service to the Government on amending the procedure used for placing lower price limits. It happened at the end of last year, so it could hardly be discussed at the last briefing, only as a project.

At the end of last year it was submitted to the Government of the Russian Federation. Until now this is under discussion by the Government. We have reminded the Government and the Ministries addressing this issue, namely the Ministry of Economic Development, the Ministry of Energy, and the Federal Tariff Service that it is necessary to settle the problem. We hope that a decision will be made shortly, as there is neither rejection nor decision until now. We'll see.

QUESTION: Anastasia Goreva, Argus Media agency. How many funds does Gazprom plan to invest in Power of Siberia until 2018? How do you plan to divide this investment per year starting from 2016?

Do you plan to roll back investments in Bovanenkovo – Ukhta and Southern Corridor next year compared to this year?

ANDREY KRUGLOV: This year a little over RUB 30 billion has been budgeted for Power of Siberia. As for the allocation of funds per year, namely 2016 and 2017, we expect to invest some RUB 200 billion in 2016 and some RUB 250 billion in 2017. And I want to underline that these are just forecast values.

As for the possible reduction of investment, in fact, we are not going to do it. Southern Corridor is among the Company's priority projects, therefore we'll keep working in this area.

ANASTASIA GOREVA: Any reduction of investment in the Bovanenkovo – Ukhta project?

ANDREY KRUGLOV: It hasn't been under discussion yet.

MODERATOR: Thank you. The Press Conference is over.