

Press Conference
Gazprom's Financial and Economic Policy
June 28, 2018

MODERATOR: Good afternoon, colleagues. Today, we are closing the series of Press Conferences in the lead-up to the annual General Shareholders Meeting of Gazprom. As usual, our last Press Conference is devoted to the financial and economic policy of the Company.

Taking part in today's Press Conference are:

- Andrey Kruglov, Deputy Chairman of the Management Committee;
- Elena Vasilieva, Deputy Chairman of the Management Committee, Chief Accountant;
- Alexander Ivannikov, Head of Department;
- Karen Oganyan, Head of Department;
- Vitaly Khatkov, Head of Department;
- Mikhail Rosseev, Deputy Chief Accountant.

I now yield the floor to Andrey Kruglov and then we will move on to your questions.

ANDREY KRUGLOV: Thank you very much.

Good afternoon, ladies and gentlemen, dear friends. I am happy to see all of you in this room. This is our first Press Conference in St. Petersburg and it's very nice to see people I've known since our Moscow conventions, all those who pay attention to and take interest in our Company.

In the course of the Press Conference, I will inform you of the key results of Gazprom's financial unit and the challenges that are facing us, and then my colleagues and I will answer all your questions.

The Press Conference on the financial and economic policy usually concludes the series of briefings in the run-up to the annual General Shareholders Meeting, which will be held tomorrow for the first time in St. Petersburg.

First of all, I would like to draw your attention to the following legal information of high importance that needs to be highlighted because the presentation and the follow-up discussion will involve forward-looking issues, which are not reflected in the official reporting.

(Slide 2) In 2017, the average annual prices of the Urals oil grew 26 per cent from 2016, while our average export price of gas in Europe went up by 18 per cent. Higher energy prices combined with our cost management efforts have a positive effect on the Company's financial results.

Yet, despite the market revival, we hold to a conservative financial policy. This also applies to budget planning, investment program prioritization, and reduction of operating expenditures. Besides, we are taking appropriate measures for financial risk reduction and efficient debt management.

The oil price today is at the level of late 2014 – above USD 70, but our budgeted price is below USD 44. Despite a strong advance in oil and gas prices in international markets, in the budget we set gas export prices at the level of the previous year – USD 197 for 1,000 cubic meters. We also determine the spending limits in line with these conservative assumptions.

(Slide 3) As I have already pointed out, Gazprom was doing well last year despite the continued volatility in the oil and gas market. We achieved positive dynamics on such key indicators as revenues and EBITDA with an increase in oil and gas production, as well as record-high exports of gas to Europe.

In 2017, the Gazprom Group's revenues in rubles went up by 7 per cent from the previous year. Furthermore, our gas business is effectively supplemented by the oil and power generation segments. The ruble- and dollar-denominated EBITDA for the reporting period grew by 11 and 27 per cent, respectively.

Net profit for the year slightly lowered from 2016, mostly as a result of the high base effect of the previous year, when the ruble revival resulted in major non-cash gains from foreign exchange operations in the amount exceeding RUB 450 billion reflected in the statements. That is, nearly half of the net profit for 2016 was generated by exchange differences. In 2017, a RUB 11 billion loss on exchange differences was recorded.

Besides, Gazprom's financial results in 2017 were affected by the Stockholm Arbitration Court's decisions in the litigation with Naftogaz. As you know, we are challenging these decisions, but, in line with the accounting requirements, we had to record their results in our financial statements for 2017.

(Slide 4) The gas and oil segments, which account for 74 and 21 per cent of the Group's investments, respectively, are the key elements of the Gazprom Group's capital investment program for 2018.

At the same time, above 70 per cent of the capital investments in the gas business is attributed to the parent company's investment program, which amounts to RUB 1.279 trillion (including VAT) in 2018. The program priorities for 2018 are quite simple – the bulk of funds is dedicated to three large-scale integrated projects of strategic importance: RUB 426 billion is reserved for the projects aimed at supplying gas to China, such as the construction of the Power of Siberia gas pipeline, the development of the Chayandinskoye and, later, Kovyktinskoye fields, and the construction of the Amur Gas Processing Plant; RUB 182 billion is earmarked for building the offshore part of TurkStream; and RUB 115 billion – for Nord Stream 2. Additionally, RUB 164 billion will be allocated for developing the northern corridor to convey gas from Yamal, mostly via the Ukhta – Torzhok 2 and Gryazovets – Slavyanskaya gas pipelines.

(Slide 5) The Company is making significant efforts for operating and capital cost containment. Gazprom's gas production costs are among the lowest worldwide. In 2017, it was RUB 1,955, or less than USD 34, for 1,000 cubic meters of commercial gas taking into account pre-development expenditures, severance tax included. It is worth noting that severance tax formed more than half of the gas production prime cost in 2017.

In 2018, the operating costs of gas production may drop below the level of 2015.

(Slide 6) Gazprom is known as a major taxpayer in Russia. In 2017, Gazprom paid over RUB 2.5 trillion in taxes and levies to the federal budget – a nearly 30 per cent (RUB 568 billion) rise from 2016.

The tax payments grew mostly due to increases in the severance tax by 47 per cent (RUB 282 billion), the corporate profit tax – by 138 per cent (RUB 132 billion), and the property tax – by 24 per cent (RUB 29 billion).

The tax-to-revenues ratio increased in 2017 to about 39 per cent.

Upwards of 70 per cent of the total tax payments are represented by the severance tax, customs duties, and excise taxes.

It should be noted that the share of the severance tax in the aggregate tax payments advanced due to legal changes in certain calculation parameters of the oil and gas severance tax, as well as due to the escalation of oil and gas prices in international markets.

At present, an increase in the severance tax for Gazprom in 2018, as proposed by the Ministry of Finance, is under consideration. In this regard, we consider it necessary to highlight the following: the key taxes in the gas industry are linked to oil and gas prices. This maintains a balance between public dues and the Company's cash flows. Upholding stability and predictability of taxation in the gas

industry is essential because of the industry's high capital intensity and long duration of the investment process. To ensure predictability, the severance tax formula was established.

Yet, the gas severance tax formula for Gazprom has been revised several times recently. The volatility of tax rates complicates financial planning and investment decision making, as well as has a negative impact on the stock value and capitalization of Gazprom. Investors are wary of the risks associated with tax increases, especially in case of improvement in the Company's financial performance, which may result in a loss of income at their disposal.

The stability and predictability of tax rates should be imposed to secure financial planning, investment attractiveness, and positive dynamics of Gazprom's capitalization.

(Slide 7) Gazprom continues to develop the Group's centralized liquidity management system. As such, the main tasks of the single treasury, which was set up in pursuance of government directives and presidential instructions, are:

- centralized management of the Gazprom Group's cash flows;
- effective management of intra-Group liquidity;
- consolidation of the Gazprom Group payment system;
- enhancement of the financial risk management system.

The corporate cash pool system brings together the accounts of 272 companies in Russia and 45 companies abroad, making it possible to effectively redistribute the intra-Group liquidity in accordance with the needs of pool members, as well as to manage temporarily free cash. Compliance with legal restrictions in attracting external borrowings is being monitored during these operations.

To improve the quality of its treasury operations, Gazprom constantly optimizes its portfolio of financial instruments. For instance, we widely use bank deposits when placing temporarily free cash, which provides higher yields from its utilization.

It's therefore noteworthy that we only cooperate with the banks that have undergone preliminary assessment, with established credit exposure limits and a stable financial position.

(Slide 8) With account for monetary resources, long-term and short-term bank deposits, the net debt was RUB 2.1 trillion, or about USD 36 billion, as of the end of 2017. The adjusted net debt to EBITDA ratio in dollars terms was 1.4 by the year's end. This is an acceptable level of debt burden for the Company. Yet, in the first quarter of this year, the net debt to EBITDA ratio dropped to 1.1.

(Slide 9) Our financial policy aims to ensure a balanced approach to borrowings in order to keep the debt burden at a comfortable level. As shown in the table, we use various instruments, currencies, fixed and variable interest rates. For example, last year we placed four Eurobond issues in different currencies: US dollar, British pound, euro and Swiss franc. We also concluded a number of successful debt financing transactions with European and Asian banks in 2017.

(Slide 10) As I have already pointed out, we are striving to cover our capital expenditures with operating cash flow, just like in the previous 12 years. In 2017, we managed to keep our free cash flow in a positive trend, with an adjustment made for changes in the scope of bank deposits. It amounted to RUB 24 billion.

On the backdrop of the capital investment peaks in 2018–2019, the possibility of generating positive free cash flow will mostly depend on the oil and gas market conditions. On our part, we are trying to improve the free cash flow profile by pursuing the following top priority actions:

- increase in revenues due to the upscaling and diversification of gas exports, as well as raising the output of oil and gas condensate;

- optimization of capital expenditures through priority setting and efficiency improvement;
- control of operating expenditures, as well as further reduction in gas transmission costs after the launch of our new export gas pipelines.

In addition, the forecasting of the free cash flow dynamics should take into account that the oil and power generation businesses have passed the peak of the investment cycle and transited to generating a positive cash flow.

Therefore, the decrease of the free cash flow across the Gazprom Group expected in the coming years will be offset by the positive dynamics of our operating results. Despite a fairly high probability of receiving a negative cash flow in 2018–2019, we will continue to take every effort to improve its profile. There is a good chance that the cash flow will remain positive in 2018. Keeping the free cash flow in the black is among the priorities of our financial policy. As you know, our free cash flow was positive according to the first quarter results.

(Slide 11) Gazprom is committed to the corporate governance principles based on the best Russian and international practices. Sustainable efforts on improving the corporate standards are underway.

In 2017, Gazprom passed regular independent audits of its corporate governance practices, which confirmed its compliance with leading Russian and international standards.

The auditors also assessed the performance of the Board of Directors and its committees and assigned a high rating to their current development level. They also pointed out positive changes in the corporate standards that had occurred in various segments over the past few years.

In 2018, a new action plan for streamlining corporate governance, designed primarily for the current year of 2018, was formed. The plan includes the following:

- further improvement of the mechanism to ensure shareholders' rights;
- streamlining of internal guidelines and procedures, including those related to the preparation of non-financial reporting;
- continued development of corporate ethics;
- enhanced cooperation with shareholders and investors.

(Slide 12) The dividend policy is an essential element of corporate governance.

The Gazprom Board of Directors decided to recommend paying out RUB 8.04 per share for the last year. We strive to strike the balance of the Company's growth objectives, current strategic projects, and the need to sustain the necessary liquidity reserve amidst the volatile environment affecting the security of dividends.

We believe that the practice of securing dividends no lower than the previous year's level ensures the stability and predictability of payouts for our shareholders and investors. For your information, in the last five years we have increased the dividend amount by 34 per cent in absolute terms.

Gazprom is a global leader among oil and gas majors with highest dividend yields. If the Shareholders Meeting approves the Board of Directors' recommendations tomorrow, the dividend yield on payouts of 2018 may be about 6 per cent.

We will enjoy greater flexibility in determining the dividend amount after the period of peak investment loads is over.

(Slide 13) As you see, we remain conservative in our financial policy and budget planning. We budget much lower oil prices than the current level and thereby attain better results in risk reduction and cost control.

Gazprom's investment cycle will peak in 2018–2019, which is explained by the simultaneous execution of our major strategic projects due to start in late 2019. We will see a return on investments as the projects are brought online, and the Group's revenues will grow accordingly.

Most of the debts will be repaid in 2018, so we take into account the need to preserve a high level of financial stability and to keep the debt burden at a comfortable level while making plans. The proposals to increase the tax burden by the Ministry of Finance may result in a decline of financial results in 2018. We will dig up reserves and look for additional ways in order to at least partially offset this additional tax burden. We will also keep in touch with the regulator, and we believe that stability and predictability of tax rates are vitally important for financial planning and investment opportunities in the gas industry.

Ladies and gentlemen, dear friends, thank you for your attention. My colleagues and I are ready to answer all of your questions.

QUESTION: Alexey Novikov, Interfax Agency. Mr. Kruglov, normally at this stage you have some information and can give us an update on how the investment program is going to be revised following the results of the first six months of the year.

Will you please, if possible, explain the changes in the borrowing program based on the six-month results?

ANDREY KRUGLOV: We believe that the borrowing program has been approved; it currently makes up RUB 417 billion, and we plan to implement it in full.

As for the program adjustments, it is still too early to comment on them because we normally review the six-month results in September. The first half of the year hasn't ended yet.

QUESTION: Evgenia Sokolova, TASS agency. May I get back to the severance tax? The Ministry of Finance has quite clearly outlined the sum of extra tax it wants from Gazprom: RUB 72 billion after September 1. Are you negotiating a possible revision of this amount? Do you expect to bring it down?

KAREN OGANYAN: Yes, we are interacting with the Ministry of Finance, exchanging calculations and trying to work out a compromise. But the final decision in this case will, of course, rest with the Ministry of Finance.

QUESTION: Maria Grabar, RIA Novosti agency. Is the severance tax growth planned for one quarter only? Could you clarify the timeframe, what period are we talking about?

KAREN OGANYAN: September, October, November, and December 2018.

MARIA GRABAR: Is Gazprom planning to tap into the debt market soon? Is the situation around Naftogaz hindering the placement of your debt financing instruments?

ANDREY KRUGLOV: I can only repeat my answer to your colleague. We expect the borrowing program for this year to be implemented in full. So far, only about a half of it has been implemented.

You know, our usual response to the question about the borrowing program is that we will choose the appropriate instruments and timing depending on the market situation.

QUESTION: Oksana Kobzeva, Reuters agency. Following up on the previous question: you have postponed the placement of Eurobonds. Does it mean that you will attract loans instead of placing Eurobonds?

ANDREY KRUGLOV: We do not comment on our actions with regard to the instruments we will use. I can say it once again: it will all depend on the market situation, that's what we will take into account.

OKSANA KOBZEVA: You allotted around USD 4.6 billion for the legal proceedings with Naftogaz, while the total claims made up USD 2.6 billion. Why is the reserved amount higher than the total amount of the two lawsuits?

ANDREY KRUGLOV: I would like to give the floor to my colleagues from the Accounting Department to comment on this issue. However, I will reiterate what I said during the presentation: we made a reserve in accordance with the laws and the accounting requirement.

MIKHAIL ROSSEEV: Our annual statements reflect the results of both rulings of the Stockholm Arbitration Court. One of them was taken in favor of our Company, and Ukraine's debt was acknowledged. The second ruling acknowledged our debt to Ukraine under the transmission contract. Gazprom considers both decisions unfair and is currently contesting them.

Due to the need to record the obligations arising from court rulings, the statements reflected both the operations reducing the debt of Ukraine and the operations increasing our debt to Ukraine. The net effect was the same: USD 2.6 billion.

OKSANA KOBZEVA: At first, you announced that TurkStream would be financed at the expense of Gazprom and then you said that a project financing scheme would be used.

ANDREY KRUGLOV: My exact words were that Gazprom would finance TurkStream at its own expense, and then, perhaps, it would introduce project financing. I can only repeat what I said before. You are absolutely right, today we are financing it with our own means and then, perhaps, we will use project financing.

MARIA GRABAR: What, in Gazprom's opinion, will happen to the indexation of the gas transmission tariff for independent producers this year? Does Gazprom expect the tariff to be indexed after all and to what extent?

VITALY KHATKOV: Gazprom is actively cooperating with all federal authorities, and above all with the regulatory body. In accordance with the regulations and procedure, all necessary materials and substantiations were submitted to the Federal Antimonopoly Service (FAS) of the Russian Federation in March and April this year. And we had all necessary discussions and consultations with the government bodies.

We also consulted with the Ministry of Economic Development and the Ministry of Energy. We believe that the FAS is well-positioned to make such a decision. All the more so that the forecast of socio-economic variables provides for an indexation starting from July 1 this year.

We see no impediments to making such a decision. Moreover, as we know, the FAS has stepped up its efforts in this regard, and the drafts of such orders are available on the website regulation.gov.ru. We think that this decision should be made because there are good reasons for doing so.

QUESTION: What amount of indexation do you expect?

VITALY KHATKOV: We can't comment on the moves of the federal authorities. We only mean that, by virtue of their authority and in line with the materials provided, such a decision can, and probably should, be made.

OKSANA KOBZEVA: One more question concerning Nord Stream 2. How far can the project cost rise if it has to be routed around the territorial waters of Denmark?

ANDREY KRUGLOV: We don't expect the cost of the Nord Stream 2 project to rise.

OKSANA KOBZEVA: You mean for this particular reason?

ANDREY KRUGLOV: Not for any reason. Nothing can cause an increase in the cost of the Nord Stream 2 project. We are planning this.

EVGENIA SOKOLOVA: Are you holding detailed negotiations now to attract project financing for Nord Stream 2?

ANDREY KRUGLOV: As regards financing issues and project financing in particular, yes, we are

doing it now.

QUESTION: Jaroslav Koribski, Hospodarske Noviny newspaper. The first question is about investments in LNG projects. Are you planning any investments for 2019–2020?

The second question, perhaps an unconventional one, is about non-core assets. Are you planning to dispose of any such assets? For instance, Gazprom has a large structural unit, Gazprom Pitaniye. Other oil and gas companies have outsourced or sold such units. Are you going to dispose of Gazprom Pitaniye to improve your financial and economic performance?

ALEXANDER IVANNIKOV: The first question is concerned with the financing of LNG projects.

You are well aware of the projects that we are running now, such as the LNG plant near the Portovaya CS. Today there is a small amount, around RUB 35 billion, dedicated for financing purposes in 2019.

All the other LNG projects have not yet been approved for financing. The appropriate decisions will be made in the course of discussing the details of the investment program for next year.

As for Gazprom Pitaniye, it is likely to be a more complex issue, and it concerns the presence of non-core assets within Gazprom's structure.

Gazprom adopted a program whereby a non-core asset, according to the program's objective, should be brought to the profitability level in order to become self-sustained, otherwise a decision is made to dispose of the asset.

In general, the point at issue now is that we shouldn't keep unprofitable assets, and work in this area is underway.

QUESTION: Mikhail Kalmatsky, RIA FederalPress agency. A question about dividend payouts. RUB 8.04 per share is nearly twice less than expected by the Ministry of Finance.

Why doesn't Gazprom conform to the payment expectations or standards the Ministry of Finance would like to set for it? Is it possible to start complying with the standard that the Ministry of Finance expects from companies with state participation?

ANDREY KRUGLOV: About dividend payouts: firstly, Gazprom pays dividends in accordance with its dividend policy approved by the Board of Directors and in line with the decisions made by the General Shareholders Meeting of Gazprom.

The dividend policy states, and our leader has repeatedly stressed it in his speeches, that Gazprom's management is keen on keeping dividends from going down. In fact, the payouts remain at the level of the last year and the last period.

I will say once again what I have already said in my presentation: Gazprom's investment load will peak in 2018–2019. I think it is highly important in this case to reach a compromise between the Company's growth plans and the level of dividend payouts.

In the end, Gazprom's payout for the current period will be determined at the General Shareholders Meeting tomorrow. It is within the purview of the Company's Board of Directors to change the dividend policy.

QUESTION: Vitaly Sokolov, Energy Intelligence portal. Mr. Kruglov, as you informed us, Gazprom is not going to revise the borrowing program this year. But would it be possible for you to borrow less since the gas price in Europe is on the rise and the overall market situation has improved?

ANDREY KRUGLOV: We are not ruling out such a possibility.

MIKHAIL KALMATSKY: Is the Company contemplating to initiate any programs that could add to its capitalization?

In recent years, the capitalization moved upwards and downwards, its growth was unstable and unimpressive. Will you take any measures to boost capitalization and stimulate your profitability and attractiveness for shareholders?

ANDREY KRUGLOV: We believe that Gazprom is taking systemic and consistent efforts aimed at enhancing its efficiency and reducing costs, which is evidenced by the financial and operational indicators of the Company.

In respect to, as you have just said, capitalization fluctuations, it is easy to see which events brought them about. They were mostly due to events that are beyond the control of Gazprom's management.

QUESTION: Lyudmila Podobedova, RBC newspaper. In 2017, a Swedish fund sold Gazprom's shares among other blocks of stock. How does the matter stand now? Do you have any new shareholders from among funds or, conversely, is anyone withdrawing?

If there were major withdrawals or accessions – for instance, with 1 per cent of the participating interest – could you tell us what kind of funds they were? If they obtained Gazprom's shares, how did you attract them, and if they quit, on what terms?

ANDREY KRUGLOV: I can't speak for the funds as to their withdrawal terms. And what got their attention was, of course, our strong performance and excellent indicators.

In response to your question about changes in the composition of foreign shareholders, I would like to note that, although the total percentage of our Asian shareholders is currently quite small, it has doubled over the past few years. We are observing keen interest on the part of investment funds and companies from Southeast Asia, such as Singapore, Hong Kong, China, and South Korea.

But, just as before, if you look at the balance of our foreign shareholders, the bulk of them are funds from the USA and the UK. That has remained unchanged.

MODERATOR: We are receiving questions online as well. Dmitry Bandura, Nikkei newspaper, is asking: "Gazprom mentioned its plans to issue bonds in Japanese yen. When is the issue offering expected and in what amount?"

ANDREY KRUGLOV: We are considering all possible options – any currencies, any investors, any instruments. We are not ruling out this option either.

MODERATOR: Thank you very much, everyone. The Press Conference is over.