

## Overview of Questions and Answers Session on Investor Day

London, February 9, 2010

### Main presentation

*Vlasenko Marina, Commerzbank*

*As far as we know, the gap between the TTF prices and contract prices has become quite significant. What is the current situation between E.ON and Gazprom regarding the renegotiation of the contract terms, closer to TTF price levels? What is the timeframe for these negotiations? What potential changes can you foresee regarding price formulae in this contract?*

**Alexander Medvedev, Deputy Chairman of Gazprom's Management Committee and Director General of Gazprom export**

I would like to officially notify you that our negotiations with E.ON Ruhrgas have successfully been completed. They were going on in two simultaneous areas: the German and Hungarian markets. We were able to reach a comprehensive package agreement which is of mutual benefit. This solution enables us to sell the volumes of gas under the contracts that we have concluded with E.ON Ruhrgas, both in the German and Hungarian markets. These negotiations were not easy, but as far as the German side is concerned, I never received a request to adjust the long-term prices down to TTF, Zeebrugge or NBP levels. I believe that this kind of issue would have been viewed as absurd. So, you have not given up the hope to buy 1 billion cubic meters of gas on a spot price level for three years. I would be eager to offer you a commission, if you have time during the break.

It is easy to check that this is not possible. We had statements from the media that everything must be brought down to the spot level, and we have done some serious analysis on aspects. There are available statistics, starting from 1980, in Henry Hub, and although it may not be appropriate to compare Henry Hub with our European prices. The last 30 years have been seven long periods of time, during which the Henry Hub price was much higher than our long-term contracts. That is the first conclusion. The second conclusion, concerning NBP, is that, as of 1990, 20 years ago, there have been four periods when quite significantly and for a long period of time spot prices were higher than the long-term contracts. I have not been working at Gazprom for 20 years, but over the past seven years I have noted two periods, during which I was sitting by the telephone day and night, waiting for someone to call and offer to switch over to spot pricing. Not a single call came in.

Seriously speaking, the spot market plays a certain role and significance, which we were able to note in contracts without changing the basic principles. They are quite simple, and the backbone of pricing is the oil relationship. I cannot disclose all details, but I can say that these adjustments enable our customers, who are major market operators, to optimise their portfolio that is not only made up of Russian gas, and retained competitive advantages in their markets. Five years ago, this conversation would have been different – you could have pulled wool over our eyes with the spot fables. We now work in this market ourselves, in the UK, Germany, France, Austria, Italy, and we know about the way this market works; not from the books but from our personal experience. We have the best experts we were able to recruit from across the world; in Gazprom Marketing and Trading, there are people of 36 nationalities who are the best traders and marketers in Europe. That

is why they are capable of utilising the full arsenal of risk minimisation in trading, so that our customers can enjoy gas at competitive prices. I am sure this trend will prevail.

We have now finished negotiating not only with E.ON Ruhrgas but also with Eni and Botash, and we are now in the final stages of negotiating with GasTerra. The principles have been applied in all cases. Fear has very big eyes, as one famous Russian writer used to say. Crisis is not in the street; it is in our minds, particularly the financial crisis, which came from bankers' minds rather than the producers.

***Oswald Clint, Sanford Bernstein***

*Q1: Can you please talk about the mechanism for pricing that you would like to achieve with the Chinese, after your recent discussions? Is it oil linked? Are the Chinese looking for an upper cap on how the prices move within those contracts? Overall, can you say how difficult it is to try and move forward the discussions with the Chinese? It is obviously a very interesting market for you.*

*Q2: Also, you have shown the supply volumes into Russia; it seems to be more coming from the independents. Are you happy with this situation to allow the independent producers to materially grow their market share in Russia?*

**Alexander Medvedev**

The Chinese market, to us, is a priority strategic destination, and I would like to inform you that we have already started selling gas to China. If I am not mistaken, we have now sold two LNG tankers from Gazprom, not Sakhalin Energy. These are at the highest possible price you might find in the history of Chinese gas procurement. As far as the principle concerned, the pricing has been agreed upon and reflected in the basic terms and conditions. The price will be connected to Japan Crude Cocktail (JCC). It is obvious that our Chinese counterparts, led by the Communist Party of China, buy low and sell high. We also remember that principle and follow it.

**Vlada Rusakova, Member of Gazprom's Management Committee and Head of Strategic Development**

The slide 9 shows volumes of sales from volumes of production. That doesn't mean that Gazprom's share is to decrease.

***Lev Snykov, VTB Capital***

*I have a question about the Nord Stream and the 20 bcm which was contracted. What will happen to the contract commitments in case of delay of the pipe construction? Will they be postponed? Will they be able to supply and deliver these volumes through alternative routs, and will be there an obligation to do so?*

**Alexander Medvedev**

I would like to draw your attention to the fact that we have contracted for 55 bcm, covering both lines. I am not in a position to tell you today who ended up having which volume, but as far as the risk of delay or postponement is concerned, these risks are minimal now, and there is no doubt that we will start operations in the designated timeframe. The scheduling contains contingency elements. We do not plan on doing the major Communist project in a short period of time; we are relying upon the tanker and pipeline layers, and the capacity. We have an ability to slightly shift volumes in case of a possible delay. So, there are no risks or financial ramifications in terms of our contract commitments.

***James Henderson, Lambert Energy***

*You spoke about LNG from Russia competing in the US market, and you recently announced that you delayed the Shtokman field by three years. I was wondering if you could talk about the lowest price in the US at which Shtokman could compete – i.e. what is the minimum price at which you could sell into the US and still make a profit from Shtokman?*

**Alexander Medvedev**

What should the minimum price in the US market for a mass production of shale gas be, in order to make it profitable?

***James Henderson, Lambert Energy***

*That was not the question. What is the minimum price at which you could sell Shtokman gas? There must be a price below which it does not make sense to sell it. That was my question; the price of shale gas is irrelevant.*

**Alexander Medvedev**

We have come up with such estimates based on the preliminary data of costs for the Shtokman projects. The range of the price data is quite broad because it corresponds with the project's FEED stage, which has been accomplished. I would like to draw your attention to the fact that quite recently at the Board of Directors of the Shtokman development company, a very innovative decision was made to split the process of investment decision making into two phases. The first one covers the production and the delivery of the pipeline gas to the shore end. The second phase is an investment decision for the LNG plant, which would enable us to do this project without any delays. This is compared to a one-off investment decision.

The range of the capital spending soon will be bigger than what we saw during the project stage. So the price that would enable us to sell gas in the North American market is \$5.5 for one million BTU.

**Mark Fletcher, Citigroup**

*Q1: Could you spend some more time looking at the demand outlook for 2010? In your forecast there is a 15% improvement in the European sales for Gazprom. Is that contractual? Is it what you see in terms of demand? Or is it the background in terms of indigenous supply falling more quickly than we thought?*

*Q2: Also, could you give some more perspective on Yamal and the Bovanenkovskoye field, and exactly when we should expect the projects to start coming through?*

**Alexander Medvedev**

We have paid attention to changing the outlook for European economic development, which can only make everyone feel happy in terms of energy and gas consumption. That makes us think that the demand is going to be greater, despite some of the crises which are still stinging the economy. The volume we have mentioned, which is 160.8 million cubic meters, includes the level of minimum off-takes under the take-or-pay terms in our contracts. It also covers make-up volumes, which will be done in 2010, in terms of the amount our buyers have to off-take in case the gas is not taken in 2009. It also includes new volumes for the build up of volumes within our contracts. There is more than one like that. So, we are currently finalising agreements with Poland for additional volumes (new volumes). All these factors enable us to target 160.8 billion cubic meters of gas.

**Vlada Rusakova**

The second question was on the timeframe for the Bovanenkovskoye and the gas supply systems to the unified gas transportation system. You should understand that these things are related to demand; we have slightly reduced the pace of the construction in these projects. From the expectations we see in the market today, we intend to commission operation by the end of 2012. That is when we expect to commission the Bovanenkovskoye field, and when the first pipeline will go from Bovanenkovskoye to Ukhta. Practically all the construction capacities, in materials and support, fit the scheduling. In case the demand expectations change, we may adjust time frameworks of the project depending upon market conditions; although we are not really thinking about this. We are still planning for the end of 2012.

**Eoghan Flanagan, Occam Asset Management**

*We spent some time talking about your revenue side, volumes and prices. I was wondering if you could give some colour on your expenses in the third quarter and year to date. Transport costs and taxes were higher than most analysts expected; I guess this was because of export volumes being higher. Other operating expenses were significantly higher than most analysts expected – at 65 billion roubles in the third quarter, which is a large number, even for a company the size of Gazprom. Could you tell us some of the factors behind this, and what expenses we can expect going forward?*

## **Mikhail Rossev**

There have been basic reasons for changes in Gazprom Group results which we discussed during the teleconference, when we were speaking about the nine-month period. The main reason behind the operational costs was the growth of the gas purchase costs, because of gas prices growing from central Asian producers. If talking about other costs in 3Q, you should mention two main factors; the first one is acknowledgement of receivables, expressed in hard currency and their valuation, and the growth of other expenses, primarily because of the operations of a number of our subsidiaries, following the consolidation of assets. Regarding transportation costs, one should note two things. First, the gas output in the third and fourth quarters and the consequent growth in transit volumes and relating costs, and the transportation tariff growing as well. We do not expect any dramatic change to costs in the future, because the trends will remain at the current year level.

## **Alexander Medvedev**

I would like to draw your attention to the fact that in a relationship with our central Asian colleagues we were able to move away from the redundant, and in many cases poor, practice of working under fixed prices, which every time were being fixed by the end of each year and in many instances had no relationship to the reality in our core markets. This is all in the past; for all sellers price formula is based upon the oil product basket and prices are comparable with an adjustment applied to the length of transportation between countries. So, currently we leave our counterparts in a civilised environment where contracts fully adhere to the terms and conditions we have with our buyers. That enables us to sell this kind of gas at an acceptable level of profitability. We have information about the way our competitors work with the gas they buy; we work as well as they do.

## ***Tatiana Boroditskaya, UBS***

*Do you have a range of what the Total Debt/EBITDA ratio should be?*

## **Andrey Kruglov, Deputy Chairman of Gazprom's Management Committee and Head of Finance and Economics**

We have already mentioned that we see for ourselves the acceptable level in the range of 1.5-1.6. Once we have achieved the level of less than 1 in our reporting as well. Even if it reaches 2 we do not view this as being tragic. But it won't be that high. We expect it to be around 1.7, by the end of 2009.

## ***Participant***

*What is the oil price you use for the current year budget?*

## **Andrey Kruglov**

Generally speaking, and according to the principles we put in the budget, such as the dollar exchange rate and oil and gas prices, we use data which the Ministry of Russian Economy writes into the federal budget. As Gazprom is one of the biggest taxpayers, the federal budget and our

budget should be compatible. Following the decision of the Board of Directors and the Federal Government Directive, our figure complies with the Ministry of Economy outlook. For 2010 it is \$54, a very conservative figure.

## **Questions to Gazprom Neft**

### ***Oswald Clint, Bernstein***

*What assets are underpinning the 100% increase in production by 2014? It seems to be very optimistic, particularly in light of more modest outlooks from some of your larger oil company peers. Also, focusing on the Priobskoye field, could you tell us what the outlook is and what the production estimates are for that asset over the next couple of years?*

### **Vadim Yakovlev, Gazprom Neft CFO and Deputy Chairman of the Management Board**

As for the plans to increase gas production, our strategic production profile includes the Messoyakhskoye and Kuyumbinskoye oil fields, which are in the Slavneft area of operations. We are going to implement this project jointly with TNK-BP. They are major fields. In Messoyakhskoye, we expect the maximum level of production to be approximately 60 million tonnes. This oil field has not been completely explored yet, which leaves potential upside for further increase of production. We expect to produce more at this field going forward. In the Kuyumbinskoye field, the maximum level of production is approximately 13 million tonnes per year. Novoportovskoye field is another major asset which is now on Gazprom's balance sheet. A decision has been taken to transfer this asset to Gazprom Neft and we hope it will happen before the end of this year. The estimated production will be 6-6.5 million tonnes.

We have clear visibility on these projects; the oil fields are already being explored and developed. Regarding our foreign assets, we have entered into the Badra project in Iraq. This is also a major project. The maximum production level is estimated at 6.57 million tonnes. Apart from Iraq we are considering other opportunities, including participation in the consortium of Russian companies in Venezuela, which is also a major project. The oil field in question is Junín 6 and the estimated volume of production is 20 million tonnes. In addition there are shelf oil fields owned by Gazprom and we also intend to participate in tenders for the sale of oil fields from the undistributed oil field fund of Russia. There are some fields located, very attractively, near our infrastructure and existing oil fields, for example, Imilorskoye field in Noyabrsk region, Erginskoye field in Khanty-Mansiysk district. There are a lot of projects, they are understandable and straightforward, and we believe that we are realistic in our estimates with regard to the increase of oil production.

Regarding the Priobskoye field, in 2009 we produced approximately 8.9 million tonnes, and daily production at the field increased by approximately 20%. We believe that we understand it very well now; we have additionally performed 3D seismic surveying in the field and drilled exploration wells during 2010; we intend to increase production at the asset.

***Florence Roche, SocGen Credit Research***

*Could you explain how you cover your funding needs between the loan and the bond markets? Do you intend to finance more debt through the bond market in roubles and euros?*

**Vadim Yakovlev**

Our current level of debt is at a comfortable level, approximately 1.2 EBITDA. We have a certain margin for the increase of our loan portfolio. The debt/EBITDA target is envisaged in our financial policy – it is 1.5. We may further increase the volume of our debt portfolio. We will continue to optimise and refinance our debt next year; in particular we now hold a Vnesheconombank short-term loan at Libor + 5, and when we see the current market environment allowing us to refinance the loan on attractive terms, we have intentions to do so during this year.

We are considering a wide range of instruments to achieve this, including syndicated loans, bilateral loans, rouble-denominated debt and rouble-denominated bonds. When we raised that in roubles we did a swap into US dollars. Last year the rate on such a synthetic instrument was approximately 4.5-5%, which was an attractive level. We would consider using this instrument this year. The choice of a specific instrument depends on the offers we will receive and the market environment.

#### **GEH questions**

***Participant***

*What is the amount of capital spending for this year and next year?*

**Denis Fedorov, Head of Gazprom's Directorate for Development of the Power Generation Sector and Power Generation Marketing**

For 2010 it is approximately 50-60 billion roubles, covering all four companies. I would say the figure for 2011 would be in the same parameters.

***Participant***

*Could you talk about demand destruction and the ability of the consumer to absorb your higher electricity tariffs by 2011?*

**Denis Fedorov**

We believe that consumers are able to digest the tariff decisions that are being made. It has been mentioned in several occasions this year that the heat and power cost of the main industrial

producers has been substantially lower than in Europe. Therefore consumers are quite relaxed about heat and power tariffs growing in the future. With the exception of aluminium producers, such as Rusal, which has direct contacts with power plants, there is not a single industrial operator who has voiced concern with this prospect.

### ***Participant***

*I would like to ask about your gas business. Do you expect any changes in terms of taxation for the gas industry in 2010 or the immediate future?*

### **Andrey Kruglov**

Our discussion with the government about possible raising or not raising the mineral production tax has been quite intense and active during summer 2009. You know that there was a decision not to raise this particular tax, and it also touched upon the export tariff increase. In 2010, following the results of 2009, I believe that somewhere in Q1 and Q2 this issue will arise and the government will be assessing the extent to which the measure has been justified. In my opinion, if the decision was made before 2011 to keep the mineral resource tax unchanged, the current economic decision in Russia makes it possible to do so. There have been various issues relating to tax rates being changed because of the crisis, so currently all of the consequences have been overcome. The way the economy is going to go forward is feasible and apparent, and it seems that we will be in a position to find the necessary arguments to convince the government of the importance of keeping these rates unchanged.

### **Alexander Medvedev**

I would like to add a few thoughts and comments on the customs clearance processes in relation to the exports of the natural gas. We saw several statements in the media that did not truly reflect our negotiations with the government authorities. There have been a number of broad issues, with respect to various processing of paperwork as far as initial gas exports were concerned. All these issues have now been settled. That applies to the export customs duties levied to similar exports of oil, and as a result, it was deemed as inappropriate. This was a very important achievement.

Secondly, there has been quite a heated debate on customs declarations. Both with the government and our counterparts in Customs, we were able to prove that everything we had been doing for the past 40 years fully complied with the specifics of the gas market. Our argument was quite straightforward. There is no routing in the gas business. From point A to point B gas can come not following very specific routing but through a balance supply settlement approach, including from underground storage.

So, it was a very business-like discussion. It took too much time but finally a decision was made, to the extent that all of the conflicts become a matter of the past.

***Oleksiy Soroka, BNP Paribas***

*What is your understanding of the future for the introduction of the consortium for managing the operation of gas transportation through Ukraine, following the results of the elections there? This was one issue that was raised by incumbents. How might this affect the South Stream project, if at all?*

**Alexander Medvedev**

We have paid attention to the statement by Mr Yanukovich that he is supporting the idea of going back to the gas transportation consortium project. This project is an old timer because during President Yushchenko's office he did everything in order to berate the idea using the characteristics that are being used in Gazprom's advertising – that the Ukrainian pipe is a national asset. But to speak twice about the same thing is incorrect. We are ready to go back to the idea, because a lot of work was done and various propositions were made to our western European counterparts to enter into the project. Respective framework documents have been signed, and so we will be looking forward to what might follow these statements.

Regarding the South Stream project, no matter what is the destiny of such a consortium, we are not changing our plans. The basic option for the South Stream is 63 bcm. It does not mean we are not looking at other options, but nevertheless the base scenario in the feasibility study is 63 bcm. In order to avoid any speculation, we are creating a comprehensive, diversified system for the supplies of Russian gas for exports. The South Stream decision has not been related to the Ukrainian situation whatsoever.