OAO NOVATEK

Third Quarter 2015

Financial and Operational Results – Earnings Conference Call

29 October 2015
Moscow, Russian Federation

Operator:

Good day and welcome to the NOVATEK Third Quarter and Nine Months 2015 Results Conference Call. Today's conference is being recorded. At this time I would like to turn the conference over to Alex Fak, oil analyst – Sberbank CIB. Please go ahead, sir.

Alex Fak:

Good day, everyone, and thanks for tuning in. I'm Alex Fak with Sberbank CIB and I am happy to introduce Mark Gyetvay, the CFO of NOVATEK, and Alexander Palivoda, the Head of IR. I'll now hand over to Mark.

Mark Gyetvay:

Thank you, Alex.

Ladies and Gentlemen, Shareholders and colleagues good evening and welcome to our Third Quarter 2015 earnings conference call. I would like to thank everyone for joining us this evening, and again extend our sincere gratitude to Sberbank-CIB for organizing and hosting our earnings conference call.

DISCLAIMER

Before we begin with the specific conference call details, I would like to refer you to our Disclaimer Statement as is our normal practice. During this conference call we may make reference to forward-looking statements by using words such as our plans, objectives, goals, strategies, and other similar words, which are other than statements of historical facts. Actual results may differ materially from those implied by such forward-looking statements due to known and unknown risks and uncertainties and reflect our views as of the date of this presentation. We undertake no obligation to revise or publicly release the results of any revisions to these forward-looking statements in light of new information or future events. Please refer to our regulatory filings, including our Annual Review for the year ended 31 December 2014, as well as any of our earnings press releases and documents throughout the past year for more description of the risks that may influence our results.

SUMMARY HIGHLIGHTS

The commodities, currency and equity markets continued to be extremely volatile during the reporting period with benchmark Brent crude oil prices averaging $51 per barrel versus $62 per barrel in the second quarter ("2Q") and $102 in the third quarter 2014, as well as the depreciation of the Russian rouble to the US dollar by 19%. The news flow from the oil and gas sector globally remains quite bearish as companies slash capital budgets and announce large employee reductions to cope (or survive) during this period of lower prices in the US oil and gas industry, companies are reporting large asset impairments and significant stress to balance sheets due to significant borrowings during the period of higher oil prices. The combination of these events has severely depressed equity valuations and is a recipe for continued stock market volatility.

Last week, I read a report stating that approximately $65 billion of asset impairments were announced by US oil and gas companies during the first half of 2015 and that this amount is expected to rise significantly over the next six months as banks monitor and assess asset bases to support reserve-based lending redeterminations. In other recent industry news, the Edinburg-based energy consulting firm, Wood Mackenzie, reported that as much as $1.5 trillion of investments destined to new North American oil and gas project are uneconomical at a sustained $50 oil price level. These are staggering impairment numbers, exceeding those already written-off during the economic crisis of 2008 to 2010, as the oil and gas industry significantly leveraged their balance sheets through debt during the recent high commodities prices and again serves as a good proxy to consider low-cost producers and those companies with strong balance sheets in today's pricing environment.

I am glad to report that the malaise impacting the US, and for that matter, the global oil and gas industry, has not negatively affected NOVATEK and/or our Russian oil and gas peers to the same degree although we expect this overall reporting season to be generally weaker. As an exercise to our assess our operational and financial performance we recently benchmarked our operations relative to our international peers, comprised of super independents and international majors by assessing the sources and uses of cash during the first half 2015. As expected, the results were strikingly different as NOVATEK's cash flows from operations significantly exceeded our capital expenditure requirements whereas our international peers and international majors either had to borrow money to fund their capital programs or resort to asset disposals. In fact, it appears that both groups – international peers and international majors – to some extent borrowed funds and/or cut capital expenditures to maintain dividend payouts, which was not the case for NOVATEK and our Russian peers.

So, why I am highlighting this analysis on tonight's call? Firstly, I wanted to specifically reiterate again the robustness of our financial and operational business model and its resiliency in a lower commodity price market as was the case in the last commodity down cycle in 2008 and 2009. We maintained relatively strong financial performance metrics vis-à-vis the global energy sector and I believe will be the case in today's environment. Secondly, I wanted to stress some of the fundamental changes that are transforming our Company. I had mentioned on previous conferences calls that the intensity of our capital program is declining, which theoretically should improve the cash generating capacity of our asset base as well as the returns generated from these same assets. We already announced substantial reductions in our capital program for our core asset base as we move from growth capital to maintenance capital over the next two years. This will free up discretionary cash flows for future growth projects, some of which we are currently assessing, and debt service repayments among other things.

Finally, the gradual shift in our hydrocarbon revenue stream from domestic natural gas to international liquids sales, as this shift has improved our cash flows due to better commodity pricing and higher value margins as well as balancing our future debt repayments with like-kind foreign currencies. This process will continue to evolve as we move toward the formal launch of Yamal LNG and its export earning capacity, and clearly distinguishes NOVATEK's cash flow growth prospects and our operational and capital cost advantages amongst our global energy peers.

Our financial results continue to be distorted by abrupt movements in the foreign currency markets. We reported another non-cash foreign exchange loss of RR 2.3 billion during the Third Quarter 2015 versus a non-cash foreign exchange gain of RR 1.3 billion in the Second Quarter at the Group level but, more notable was the significant non-cash foreign exchange loss at our joint ventures of RR 37.5 billion. These non-cash foreign exchange movements, either gains or losses, have significantly distorted our net profit line and are driven by the significant foreign-denominated borrowings at the joint venture level, mainly Yamal LNG, as well as to some extent at NOVATEK from the prior issuances of dollar-denominated Eurobonds. To counter-balance this trend, we have significantly increased our foreign earnings capacity with the ramp-up of our liquids production over past two years, and we believe that this present foreign currency exchange issue does not represent a major problem for us in the future as the expected revenues generated from the Yamal LNG project will be denominated in foreign currencies combined with our present liquids growth, represents a better match with future debt repayments.

Despite the bearish operating environment and present volatile markets, we remain very optimistic about our future exploration and development prospects as well as our ability to consistently demonstrate the cash-generative nature of our unique operations and the resiliency of our business model. We have built an asset base and cost structure that serves us well in these market conditions.

The Yamal LNG project remains the dominate question among investors and analyst, so I will provide our latest project status update as has been customary in the past. We remained very busy this past quarter at the Yamal LNG project and presently have approximately 12,600 workers on site as well as approximately 24 thousand people working at construction yards involved in various module fabrications. There are about 2,460 construction vehicles on site, so it is quite active from both the standpoint of workers and equipment at the construction site.

Yamal LNG external financing continues to move forward as we are in the final stages of collecting credit approvals from financial institutions. As of today, the overall amount of credit approvals received already exceeds the USD 20 billion for the overall external financing stated in the Term Sheet; however, we are still waiting on some more credit approvals from international banks underlying some of the export credit agencies coverage. This process has been painstakingly slow as we are subjected to many different variables out of our control as well as the specific timing of credit committee meetings to review the term sheet and determine if additional questions and/or information is needed to finalize their respective decisions. Moreover, in parallel we continue to work on all of the primary loan documentation to close the external financing which is also an excessively time-consuming process.

I know this question is important to everyone and we have tried to keep all investors and analysts informed throughout this difficult process as best we can but quite frankly we are beginning to lose our patience with the excessive comments and myopic focus on this singular point as we are trying to navigate through various ministerial meetings and discussions, various credit committees, and inter-governmental requirements to name a few in a less than ideal macro and geopolitical environment. You have been thoroughly apprised of the construction progress throughout our previous earnings conference call and tonight will be no exception. We have consistently provided everyone with the latest status regarding financing so we ask you to remain patient as we finalize this process. As an example, it is my understanding that Shell was more than 80% of the cost funded during the Sakhalin LNG project before they received their external financing so I believe we are good stage in this process as of tonight's call.

As of today, the project shareholders have directly invested approximately USD 10 billion into the project (Second Quarter – USD 9.7 billion), as well an additional RR 75 billion (or ~USD 1.2 billion) was received from the National Welfare Fund of the Russian Federation in February 2015, which was obtained by the Ministry of Finance via a subscription to bonds issued by Yamal LNG, comprising a total of roughly $11.2 billion. We should receive the second and final tranche of funds from the National Welfare Fund shortly as all conditions have been met for the release of the RR 75 billion, but I can't tell you with complete certainty the exact date of this release. As I specifically stated on my last conference call when the external financing package is completed we, together with our partners Total and CNPC, will make the appropriate announcement. For now, this information is all that I will discuss on tonight's call and I will not elaborate any further information or details on this topic during the question and answer ("Q&A") session.

Overall, the LNG plant construction progress against the EPC contract is approximately 36% complete at the end of September, including approximately 44% progress toward the completion of LNG train #1. In September, we began receiving some long-lead items and LNG plant modules at the Sabetta port, and offloading, transportation to the installation point and installation works were successfully tested.

Some of the equipment already received at the project site include the full set of equipment for two compressor lines from GE, including turbines fabricated in the US, two (2) boil-off compressors representing 100% of the equipment needed for Train #1 from Siemens, the first cryogenic pump from the US manufactured by Nikkiso Cyro, all three (3) of the LPG strippers from Chart Energy in the US, and 25 low friction pneumatic values from Cameron (US) amongst various other equipment. The fabrication of the first cryogenic heat exchanger (there will be one per train) manufactured by APCI (US) is completed and tested, and is expected to be dispatched for shipment to Sabetta port shortly with expected delivery sometime in second half of November.

So far, 37 production wells (Second Quarter – 32 production wells) have been drilled and completed with three (3) Arctica drilling rigs in operation and a fourth rig as I had previously mentioned is being assembled on site. We have completely roughly 18% of the total wells needed to be drilled at the South-Tambeyskoye field, or roughly 64% of the wells needed for the first LNG train although I understand from my recent discussion with our geologist that the current well-stock is already sufficient for the first train as the wells drilled have exceeded their planned flow rates.

We continue to make progress on the interior walls, floors and installation for cryogenic LNG tanks 1 and 2, with this work more than 30% complete as of this reporting period, and we have also completed the exterior walls for tanks 3 and 4, and roofing work is presently underway for these tanks.

The main building for the 376 MW power plant is practically complete, including the fully completed section for gas turbines. Four (4) gas turbine units at 47 MWt each manufactured by Siemens were delivered to the site as planned.

Ongoing infrastructure works at the port and the ice barrier continued throughout the reporting period and, during the first nine (9) months of 2015, cargo ships unloaded roughly 2.5 million tons of cargo and we have also completed over 70% of the construction works on the South-Eastern ice barrier, which will be used for LNG and gas condensate shipment. Rosmorport completed their dredging operations during the navigation season in early October and approximately 14.8 million cubic meters of soil was dredged in 2015 and roughly 49.2 million cubic meters overall.

The Sabetta Airport has been operational for domestic flights since February 2015, and during this period, approximately 90 thousand passengers have been served and over 1,000 flights have landed at this new facility, with daily flights from Novy Urengoy as well as Moscow and Samara.

During the first nine months of 2015, we successfully launched the Yaro-Yakhinskoye field at Arcticgas and the Termokartskoye field at Terneftegas, which combined with the prior year launches, has largely contributed to the significant increase in our liquids production as well as increasing our proportion of natural gas purchased from our joint ventures. Looking ahead, we have completed construction works at the Yarudeyskoye field, including all equipment installation and pipelines, and we are currently filing the crude oil pipeline with crude oil from the East-Tarkosalinskoye field to test both the pipeline and equipment. We have drilled and completed 33 production wells, already more than necessary to launch the field, and we anticipate that upon completing the required pipeline and equipment testing we should be in a position to launch this field in December.

We fully anticipate that the Yarudeyskoye field will immediately ramp up to the field's 3.5 million tons per annum production capacity and once commissioned will contribute to our overall estimated production growth in 2015, but more likely will represent one of the main drivers of production growth in 2016 based on full year run rates. Our 2016 liquids production growth will largely consist of the full year run rates for the Yaro-Yakhinskoye, Termokartskoye and Yarudeyskoye fields.

For the nine months of 2015 we have drilled and completed 77 production wells versus 129 production wells in the corresponding nine month period, including 100% of the joint ventures. Our overall development drilling plan calls for the drilling of 103 production wells in 2015.

We continued our exploration efforts in the Gydan peninsula, and during the 3Q 2015, we discovered one (1) new natural gas deposits and one (1) gas condensate deposit at the Utrennye field. In addition, we processed additional 3D seismic at the Utrennye field to further explore the field's potential and conducted ongoing geophysical works at the North-Ob license area. The initial exploration wells drilled vertically at the Utrennye field have exceeded planned flow rates, and we plan to complete these wells using horizontal and multi-stage completion techniques. We remain very optimistic about our future prospects on the Gydan peninsula as this geographical area represents the next evolution of NOVATEK's long-term strategy and the primary natural gas feedstock for our future plans to expand LNG output.

In the 3Q and nine months 2015, we processed 3.3 million tons and 8.7 million tons, respectively, of unstable gas condensate at the Purovsky Processing Plant representing an increase in processed volumes by 93% as compared to both comparative periods in 2014. The Purovsky Plant increased its throughput capacity as a result of increasing volumes of de-ethanized gas condensate production at our producing fields and joint ventures, and by quarter-end was operating at 120% of its design capacity of 11 million tons per year. The Purovsky Plant processed 3.2 million tons of de-ethanized gas condensate, producing 2.6 million tons of stable gas condensate, and 598 thousand tons of LPG.

During the third quarter 2015, the Ust-Luga Complex processed 1.6 million tons of stable gas condensate into 1.6 million tons of refined end products, including 1.0 million tons of heavy and light naphtha and 600 thousand tons of refined petroleum products, which represented a 36% increase over the prior year period. The Ust-Luga Complex has reached it full design capacity as a result of the increase in processing unstable gas condensate volumes at the Purovsky Plant and is currently operating at 113% of its nameplate capacity of six (6) million tons per annum. During the reporting period, we began scheduled maintenance on the first train at the Ust-Luga Complex, which meant that we sent more stable gas condensate to the market rather than refined stable gas products. The first train maintenance was completed and we recently started and completed the second train scheduled maintenance in October.

We achieved reasonably strong financial and operational results in the third quarter 2015 (as well as in the nine months 2015) despite lower natural gas sales volumes and weaker benchmark commodity prices as our overall revenues increased with the continued growth in our liquids output as well as the benefit of a stronger dollar and its effect on the currency translation into Russian roubles.

Our total output of liquids produced combined with the purchases from our joint venture increased by 80% year-on-year (Y/y) and 11% quarter-on-quarter (Q/q). With the ramp-up of our liquids production in 2015, our liquids revenues represented 54% (versus prior period of 37%) of our total sales even though we continued to operate in a volatile commodity market. Our growing liquids business has changed the fundamental dynamics of our business profile and we expect robust cash flows as we transition towards higher valued, risk-adjusted margins and sustainable shareholder value creation.

We realized weaker gas sales volumes in both Y/y and Q/q, larger due to a combination of higher injections rates in storage and a reduction in output from our consolidated subsidiaries. Despite the lower gas sales volumes in the reporting period, we managed to slightly increase our average netback margins Y/y and Q/q by 12% and 11%, respectively, which represented a combination of increased gas tariffs and a reduction in transport distance in our geographical sales portfolio. The changing geographical sales mix and its corresponding impact on transport cost per million cubic meters affects the netback we receive for our gas volumes sold. Our proportional mix between end-customers and wholesale traders in the current reporting period was 94% and 6%, respectively.

The regulated tariff for natural gas and transport charges were approved on the 1 July 2015 by the Regulator (formerly, the FTS) and, accordingly, were raised by 7.5% and 2.0%, respectively. As I mentioned on the last conference call, the approved tariffs represents the first time that the Regulators have approved a notable difference in the percentage between both the gas price and the transport tariffs, recognizing our requests for a more balanced approach to maintaining the relative profitability of domestic gas sales for independent gas producers. There are various discussion currently taking place in the Government on the upcoming tariff changes for 2016 and beyond, but there is nothing concrete to report at this time.

Our total revenues and adjusted EBITDA increased by 39% and 36%, whereas our normalized net profit increased by 32%. Net cash provided by operating activities decreased Y/y by RR 2.1 billion, or by 12%, which meant that we generated Free Cash Flows of RR 2.2 billion during the reporting period, which was 67% lower than prior year. Although our capital expenditures were higher Y/y by 18%, the general trend has been a decline in our capital program toward maintenance mode as has been noted over the past several periods with the changing mix of our quarterly capital expenditures, and during the third quarter 2015, we spent RR 14.5 billion during the quarter of which RR 6.6 billion was used for ongoing work activities at the Yarudeyskoye field to support the launch of this new crude oil field in December 2015. The East-Tarkosalinskoye field accounted for RR 2.2 billion of the capital spent mainly on further development of the field’s crude oil layers, with the remaining funds disbursed amongst the Yurkhavoskoye and Utrenneye fields at RR 1.5 billion and RR 1.9 billion, respectively, and other smaller field activities.

Our operating cost mix changed during the reporting period whereby the purchases of hydrocarbons represented the largest component cost for the first time with the continued growth in the liquid and natural gas volumes from our joint ventures representing the majority of this important cost category. Purchases of hydrocarbons and transport expenses each represented slightly more that 38% of the total operating cost, with our tax obligations representing almost 11%.

The purchases of gas condensate from our joint ventures accounted for 76% of the total expense category in Russian rouble terms, with the majority of purchases from our Arcticgas joint venture and to a lesser extent Terneftgas. We continued to purchase natural gas from third parties, mainly SIBUR, and our joint ventures for all reporting periods to support our gas marketing efforts.

It is important that we maintain a strong focus on minimizing controllable operating expenses consistent with our growth objectives of the business. We continued to demonstrate strong cost controls across all categories of controllable expenses and our General and Administrative expenses were no exception. We did not experience any accelerated cost inflation pressures as far as operating expenses are concerned and, more specifically, in our general and administrative category. As customary, we indexed our general base salaries for the Group, effective 1 July, by 7%, which supports this observation. The main difference in our employee compensation Q/q was the higher payment of prior year performance bonuses in the second quarter relative to the third quarter.

Our Balance Sheet and liquidity position remained strong throughout the reporting periods although we moved RR 90 billion in long-term loans to the current portion of short-term debt reflecting our quarterly payments of the syndicate facility as well as the expected retirement of the USD 600 million tranche of our Five (5) year Eurobond during the first half of 2016. Our total debt position at the end the 30 September 2015 totaled RR 294 billion, which continues to be impacted by the revaluation of our total loan portfolio to fair market value as well as the impact from the significant devaluation of the Russian rouble to the US dollar that we experienced in late 2014 and current foreign exchange movements.

We have the necessary cash flow generation to fund our capital expenditure program through internally generated cash flows as well as having the ability to meet all of our debt obligations and liabilities when they mature or become due for payment. The Company’s ability to generate cash flows is clearly supported by our growing liquids business despite the volatile commodity pricing environment and represents one of the main fundamental changes underlying our transformation into a global energy company. Another important point to highlight is our ability to generate sustainable free cash flows (“FCF”), during the nine months 2015, we generated FCF of RR 42.7 billion versus RR 24.7 billion in the comparative period, representing a 73% increase despite a significant decrease in the benchmark crude oil prices during this period. We are confident in our ability to sustain robust FCF as we move into the next phase of our corporate development.

CONCLUSION

In conclusion, we are operating in a very difficult macro environment and the bearish forecasts over the next several quarters, especially for the commodity markets, does not bode well for companies in the energy space. With that said, we can only focus on what’s controllable from our perspective and if we look back over the past quarter and nine months of 2015, I believe we have done a great job in delivering volume growth through the superb project execution of delivering new field launches, we have maintained our strong focus on cost controls, and we have made great progress in bringing forth the construction of our Yamal LNG project, despite the sub-optimal geopolitical situation and difficult financing constraints.

Our commitment to delivering sustainable shareholder value creation is clearly embedded in our daily decisions, and we believe the platform we have built with our asset base is second to none as compared to our peers in the global oil and gas industry who are often plagued by high costs development and exploration projects, delays in project execution, and over-leveraged balance sheets to name a few.

The volatile non-cash foreign exchange movements are an annoyance to everyone trying model our business operations but I would like to stress again that it really has a limited impact on our profitability as we believe we will generate increasing amounts of externally generated cash flows to better match our future debt repayments.

We will continue to provide timely updates and notification on the progress of our works, particularly those related to Yamal LNG including the status of closing the external financing package. We just announced the execution of another contract for the delivery of natural gas to Enel Russia for the supply of 2 billion cubic meters ("bcm"), and this contract combined with the contract we announced in August for the supply of 2.8 bcm to NMK confirms our ability to market our natural gas, hopefully alleviating some of the concerns expressed recently by analysts.

I would like to again thank everyone for attending tonight's earnings conference call and your continued support of our Company. I would now like to end tonight's prepared comments and open up the session to questions and answers.

Thank you very much.

Operator:

Thank you. If you would like to ask a question at this time please press the star or asterisk key followed by the digit 1 on your telephone. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. If you find that your question has already been answered, you may remove yourself from the queue by pressing *2. Again, please press *1 to ask a question. We will now pause for just a moment to allow everyone to signal.

We will now take our first from Karen Kostanian from Bank of America. Please go ahead.

Karen Kostanian:

Thank you very much. Mark, thank you very much for the presentation. I have two questions. The first question for me would be - if you looked at your plans, initial plans for financing Yamal LNG, for the first quarter or maybe the first half of 2016, how much capex were you planning to put down towards the project and if you can, could you provide how that capex would have been split between shareholder loans, external financing, etc.?

And my second question relates to the payment of RUB 90 billion that you have – the short-term debt of RUB 90 billion that you have next year. I appreciate the very high free cash flow generation which is very – as you highlighted – very rare in this environment for an oil company, but with capex and closed external funding sources, what avenues of refinancing that debt would you have? Because on my numbers, in the first half of next year you probably won't be able to generate enough free cash flow to finance both capex and repayment of that debt. Thank you very much.

Mark Gyetvay:

Thank you, Karen. I don't fully understand the first part of your first question. Can you elaborate a little bit more exactly what you're looking for because I'm not following why you're looking at the split in 2016?

Karen Kostanian:

I was wondering how much financing the shareholders had to provide to advance the Yamal LNG project from next year, and how that financing would have been structured if it was in a normal environment. Would that be external funding? Would that be shareholder loans?

Mark Gyetvay:

Well, I believe as it relates to the fourth quarter as an example, we'll probably have to put some additional financing from partners but I don't have that number as we speak because it's really largely dependent also on the closing of the National Welfare Fund's RUB 75 billion. So it's really a function of timing of that release of funds, which will then mean whether or not the shareholders have to put additional funding until such time as that external financing comes in. So it's a hard question to answer at this point.

Karen Kostanian:

Yes, if I may clarify, I was just looking for a capex number, how much capex is required by your plan for Yamal LNG for next year. Maybe you shouldn't provide any breakdowns but how much were you planning to spend as a consortium in the first half of 2016 on the project?

Mark Gyetvay:

Well, we haven't released capex numbers yet for 2016. I'll do that in December after the Board approves – we have to get the approval of the Board at Yamal plus our approval here at NOVATEK. So I'll give you those numbers later on in December. And that also goes for production or expected growth in production numbers for gas and liquids.

As your second question, we've already been paying down – you know, we've already made payments this quarter and we will continue to make payments on the syndicate loan. We have a capacity, we have the free cash flow generation for it, we have cash on the balance sheet plus we have the ability to tap into some of the lines of credit if there is any shortfall between the timing of the payments of this RUB 90 billion – because really the big payment that's due is the $600 million tranche in the first half of the year for the retirement of the Eurobond. You know, I don't see us having any significant problem. I know you might not be able to balance the numbers as you speak, but I believe we have enough access between the discretionary cash flows that we have in place to fund, as well as the cash-generative nature of the business as we look forward for the next couple of quarters, as well as the ability to look at the closing of the Silk Road Fund which we're still working on as we speak.

Karen Kostanian:

Okay, thank you, Mark.

Operator:

We will now take our next question from Ksenia Mishankina from UBS. Please go ahead.

Ksenia Mishankina:

Hi, thank you for the presentation. On page 34 of your presentation, you mentioned that you have credit lines for RUB 50 billion in addition to a USD 300 million loan. Are they all committed and are all of them unused as of today? And the second question: what percentage of your cash balance is in hard currency? Thank you.

Mark Gyetvay:

The answer on the credit lines, I believe most of those are not committed. But we are able to tap into them when we need them. So I can't give you the exact breakdown on say, what's committed or not committed, but they're available for us and we have been able to draw down on them like we just recently drew down on some of our credit facilities in this respective quarter.

As to the cash on the balance sheet, I believe a large proportion of it I would say probably greater than about 75% is in US dollars – you know, foreign currencies, not Russian roubles.

Ksenia Mishankina:

Okay, thank you. And in terms of your credit lines, are they with Russian banks?

Mark Gyetvay:

A combination. There are some international banks. I mean we have access – we use some of the credit lines also in our trading operations, which we roll over on a regular basis to fund the payment of our cargos until such time as the funds are received. So we use, we're constantly using these facilities on a regular basis, and they're both by international banks and Russian banks.

Ksenia Mishankina:

Thank you very much.

Mark Gyetvay:

You're welcome.

Operator:

We will now take our next question from Alexander Kornilov of Alfa-Bank. Please go ahead.

Alexander Kornilov:

Good afternoon, gentlemen. Thank you very much. I have two questions.

First of all, if you can share with us, could you please provide a number of effective gas MET rate which you had in third quarter?

And second question, I have noticed that your production from the core assets, i.e. core fields which are consolidated in your numbers, is down 7% for both natural gas and for the liquids. If you could share with us the expected number for the entire year, that would be great – and maybe you could provide also the guidance for 2016, what you expect from your core assets next year. Thank you.

Mark Gyetvay:

Okay, unfortunately I don't have the average MET rate for the quarter. We'll get it for you. If you need that number for your calculations, please contact Alexander at IR and he'll give you that number. But I don't have that readily available normally as I speak.

In terms of the declines, they are a combination of factors, I mean largely driven by the reduction of our liquids content inside of our gas stream with the different downhole pressure, but you've also got to look back at the fact that some of these wells, when we look at declines, I mean it's not a straightforward answer to say that the whole field is declining. What we're looking at is some of our prior wells that were drilled, you know East-Tarkosalinskoye 1998, 1999, early 2000s had already been producing for more than a decade. They're actually in a decline at various rates. We're seeing declines in both Yurkharovskoye in some of its earlier gas production fields. We're fully confident that we'll meet the numbers that we put out on our plan for this year. As I just mentioned on Karen's question, we haven't given the guidance for 2016 yet, we'll do that in December, but we're pretty confident that we'll meet our production growth numbers and targets for 2016 both for liquids and natural gas. Just to put a little flavor on what we're doing too, to offset some of these sort of expected declines in some of the core assets, we have a portfolio of assets that we're working on such as North-Russkoye field. We're working on those assets as we speak and we expect that over the next several years as we start seeing some of the declines in our three core assets, they'll be sufficiently replaced with a growth of production coming from these new fields that will be launched, you know, in 2018-2019. So we don't look at this as a negative; we look at this as being a natural trend in the fields' development cycle as we see declines happening over time. You know, this is just a natural function of these fields. They're going to decline over time. So this is not unexpected.

I had a long discussion with our geological department yesterday on this very issue. They outlined to me the series of plans that are in place in terms of arresting some of these declines at some of the various fields. For example, in the Yurkharovskoye field, you know, we're looking at developing and we're drilling a well as we speak in the Cenomanian layer, which we're not producing significantly. We know there are a lot of hydrocarbons there. But that doesn't answer the question on the declining liquids side. It will sustain on the gas side but you know, the liquids side in the concentration is declining and that's just a natural flow from these fields. That's not going to reverse itself unless we find new deposits and/or replace them with new fields. But these are all natural declines that are fully expected in the life of these fields and our technical teams are fully aware of this and are working on this process. So we're not alarmed by these changes.

Alexander Kornilov:

Yes, fair enough. Thank you.

Operator:

We will now take our next question from Artem Konchin from Otkritie Capital. Please go ahead.

Artem Konchin:

Hi guys, thank you for the presentation – fairly detailed disclosure. I only have two small questions on your P&L, the first one related to the RUB 5 billion revaluation of the shareholder loans provided by the Group. I'm just curious what's this different methodologies that you mentioned in accounting for those.

And the second one is more broad. I was curious if you ever considered changing the IFRS accounting methodology to something similar that BP or Rosneft utilize, to avoid significant fluctuations of the bottom line on the currency shift. That's pretty much it. Thank you.

Mark Gyetvay:

On the 5 billion, it's not unusual. We've done that last year. It's just a revaluation of the fair market value on those loans. So it's not something – it has happened on a regular basis and like I said, I think last year we had almost a 7 billion revaluation so it's not unusual.

On the second question, I think that's a more difficult question that needs to be discussed with our colleagues at Yamal LNG and our partners because obviously – as well as our auditors, PwC – because there needs to be a specific trigger event to support a change in functional currency. And you know, we realize from a practical perspective that the majority of loans, the majority of contracts as well as the majority of costs are in foreign currencies. So we're working on that and I am in discussions from our perspective with PwC on this particular point. So I don't know the answer right now because they'll have to go through some technical questions, but that's something that we are considering as we speak.

Artem Konchin:

Okay, so it's a work in progress, and as far as the first question, I was just saying – I mean your report says a different methodology in valuation of the loans so I was curious if something new is…

Mark Gyetvay:

No, there's no different methodology.

Artem Konchin:

Okay. Okay, thank you.

Mark Gyetvay:

You're welcome.

Operator:

As a reminder, to ask a question please press *1 on your telephone keypad. We will now take our next question from Alexander Nazarov from Gazprombank. Please go ahead.

Alexander Nazarov:

Good evening, Mark. Thank you very much for the presentation. Two short questions from my side, first concerning your buyback program. We've all seen the press release at the beginning of this month saying that you've resumed buybacks for one week, but then again it was stopped. What was that? It was just one-off for some reasons or are you going to start again buying back your own shares at regular schedule?

And the second question is that NOVATEK is one of the few companies in Russian oil and gas which doesn't disclose the amount of export duties paid. And on the other side, you remain like one of the companies who is less hit by the proposed tax hike in 2016. So it's pretty hard for us to exactly evaluate the effect for you, so could you probably say what's your estimation or how much more export duties will you pay next year for your oil products? Thank you.

Mark Gyetvay:

Okay, thank you, Alex. The buyback program, I mean obviously we assess it on a regular basis. The program is done on an annual basis. We never said that we're going to be in the market every week. We assess it, we assess the market every day. We make a determination if we believe that we want to go in at a particular price point and buy some shares, and that's what we do. And when we do that over the course of a week, the following Monday we make that announcement. So the plan is in place, but there's no structure to say that we're going to buy every week, so we just do it on an opportunistic basis when we believe that it's important for us to come into the market to support the share price and/or we believe that the direction of the price is below our valuation point that we'd like to see for our company. We'll continue using the buyback program over the course of upcoming weeks and years, and we're not going to disclose when we're going to be in the market. That, kind of, defeats the purpose.

As to your second question on the export duty, I mean it's still a work in progress, as you can appreciate, you know, with this question on taxes. But I think the initial prognosis, considering that the government may keep the export duty, coupled with the fact that they are continually changing the product side, I think the effect will be relatively minor for us in 2016. But we don't provide the level of forecast on numbers at this particular point in time. Are you suggesting that maybe we should add a table? Would that be helpful, add a table on the export duty – you said we're the only ones that do not do this – would that be helpful for you?

Alexander Nazarov:

Yes, I mean probably colleagues would not support me, but for me it would be absolutely very helpful, yes.

Mark Gyetvay:

All right, well, we'll see. We'll take a look at it.

Alexander Nazarov:

Okay, thank you.

Mark Gyetvay:

You’re welcome.

Operator:

As a reminder, to ask a question please press *1 on your telephone keypad. There are no further questions in the queue at this time. I’d like to hand the call back to the speaker.

Mark Gyetvay:

Well, thank you, everybody. I’d like to just make a final comment and say that I know there's a lot of concern about the financing and I know there's information in the press that are basically citing unnamed sources. And I would just caution reading and reading too deep into that type of analysis because there's probability, a high probability that these people have no idea what's going on in the process and are not linked into any of the discussions that are currently taking place in regards to Yamal LNG financing. So, I would just caution that when you read this stuff – particularly when we start reading all these things about unnamed sources – if they have any information, put your name out in the press, okay, and stop hiding behind these unnamed sources if they believe they have something to say.

Secondly, I think when you look at our financial results this quarter, I mean keep in mind that given the difficult market, difficult macro environment we’re faced with right now, our results are quite good, particularly when I’m starting to read now Shell loss, Total loss, Conoco loss. I mean we’re going to see a lot of really negative financial reports coming out, and I believe at the end of the day when you look at our operations, the cash flow nature of our business, we’re going to be able to survive. I mean I was reading today about Shell telling you that they break even at $60 oil price. I mean, we have a completely different operating environment due to our very low cost base and we’re able to survive in these particular markets, although you're going to see fluctuations from quarter to quarter. So you know, keep that in mind when you're looking at the results and I think you're then going to find out that the Russian industry, despite all the negativity that we constantly read about or the questions that are constantly asked upon ourselves and our Russian peers, that we’re actually going to report relatively good numbers vis-à-vis the oil and gas sector. So just keep that in mind.

Again, thank you very much. Thank you for your patience. We’ll see you out on the road on upcoming conferences and we’ll deal with you on the next conference call. On the annual conference call, Mr. Mikhelson will be there with me so you know, you'll be able to ask him the questions directly on what's going on, on the company, the strategy, etc. And we look forward to addressing you for the full year results. Thank you very much.

Operator:

That will conclude today’s conference call. Thank you for your participation, ladies and gentlemen, you may now disconnect.