

## **Press Conference**

### **Finance and Economic Policy of Gazprom**

**June 26, 2008**

**MODERATOR:** Good afternoon, dear colleagues! So, we are finishing a traditional series of Press Conferences before the Shareholders Meeting. Today, we will discuss the Finance and Economic Policy of Gazprom.

Let me introduce the participants of the Press Conference:

- **Andrey Kruglov**, Deputy Chairman of the Management Committee, Head of the Finance and Economics Department, Gazprom;
- **Elena Vasilieva**, Deputy Chairman of the Management Committee, Chief Accountant, Gazprom;
- **Elena Karpel**, Member of the Board of Directors, Head of the Economic Expert Analysis and Pricing Department, Gazprom;
- **Sergey Yatsenko**, Deputy Head of the Finance and Economics Department, Gazprom;
- **Natalia Vavrishchuk**, Deputy Chief Accountant, Head of the Accounting and Consolidated Accounts Methodology Directorate, Gazprom;
- **Nina Lobanova**, Head of the Tax Policy Directorate, Gazprom.

Let's give the floor to Mr. Kruglov and then proceed to the questions.

**ANDREY KRUGLOV:** Good day, dear ladies and gentlemen. My colleagues and I are glad to welcome you at the annual Press Conference dedicated to the Finance and Economic Policy of Gazprom in 2007 before the annual Shareholders Meeting.

The Finance and Economic Policy of Gazprom is aimed, first of all, at securing a sustainable financial position of the Company and stable financing of its development to increase the Company's value. Thus, we continued to successfully

solve a number of tasks in 2007 including the maintenance of a balanced debt portfolio, reduction of the loan capital cost, raising the Company's credit ratings and exerting control over the debt burden level.

We believe that a balanced budgetary policy is necessary for the sustainable development of Gazprom. Last year we managed to successfully implement a Borrowings Program and to fund the obtained assets of strategic importance in the unstable environment of global financial markets. We place a special focus on cost management and inhibition of expenditures growth under direct control of our management. We try to hold them on the level commensurable with inflation rates. With a view to enhance transparency of and control over the financial and economic activities of Gazprom we introduce advanced automated accounting systems. I'll describe them a little bit later. Well, dear colleagues, let's move on to the revision of our 2007 financial highlights. You may see them in Slide 2. I would like to draw your attention to the fact that the data given in the presentation stem from the consolidated accounting statements of Gazprom Group prepared in conformity with the Russian legislation requirements. We are planning to publish the 2007 statements based on the International Financial Reporting Standards during the next week.

In 2007 Gazprom kept demonstrating high operational results. As you see from Slide 2 sales proceeds increased by 14.4 per cent over 2007. Our policy of gradual transition to market relations with the FSU countries gives positive results increasing the amount of sales proceeds by some 19 per cent. An increase of over 25 per cent was stipulated by the sales of more advanced processing products, i.e. oil and gas derivatives.

Over the recent years Gazprom has demonstrated an impressive increase in financial performance. Profit on sales by Gazprom Group has grown to RUB 770 bln. During the last three years the profit on sales and net income growth made up 150 and 145 per cent respectively. An insignificant downturn in the net income in

2007 was driven by the influence of certain factors on other profits and expenses. Negative influence was mainly exerted by the profits decrease in the “Re-estimated financial investments adjusted for the current market value” line which is related to the Russian stock market situation in the energy sector of the last year versus 2006.

Over 12 months of 2007 the cash flow from the Company’s operational activity hit a new record of RUB 537 bln. In the upper right diagram (Slide 3) you may see a 10 per cent annual increase if compared to 2006, and a 165 per cent triennial increase.

Exertion of control over operational expenses by the Company’s management is our top priority. In 2007 a growth in the expenses controlled by our management team was commensurable with the inflation level. The available positive results related to the detention of managed expenses growth rates are primarily conditioned by the budgeting arrangement. Control of expenses level starts at the stage of the budget development and continues during the budget items balancing. Draft items of expenditure representing the expense side of the budget undergo an expert evaluation. During the process experts evaluate whether the level of expenses claimed corresponds with the production program. At the same time, we follow the Board of Directors requirements demanding that the growing expenses level should not exceed deflation indicators adjusted by the Economic Development Ministry of the Russian Federation. At the stage of the budget execution a mechanism of close control over observance of budget indicators, i.e. budget limits, comes into force. Procurement and distribution of orders for contractual work are carried out on a contest basis.

Our approach to consolidated debt burden management accounts for the requirements to maintain credit ratings on the investment level as well as on the level of strategic targets of the Company’s development adopted by the Gazprom Board of Directors in July 2006.

Following the 2007 results, we managed to maintain the financial stability indicators on the targeted levels despite the growth of the Company's debt burden as of the year end. Attraction of additional funds in 2007 was effectuated to finance a number of strategic acquisitions such as Sakhalin II, Mosenergo and other energy assets. We expect that by the end of 2008 the Company's debt burden will be reduced to the levels of the previous years. We are planning to refinance and cover from our own funds the bulk of loans taken out in 2007. Our major principles of the debt portfolio management are as follows: reduce the share of secured debt, optimize repayment periods, diversify currencies and debt instruments. As you see in Slide 6, the short-term debt increment to 25 per cent is explained by the fact that the statement reflected interim financing rates while purchasing profile assets, and the deadline for long-term borrowings was nearing, which, pursuant to the accounting policy, are transformed into the short-term ones as the payment deadline is approaching.

Debt structure is improving on all the defined parameters. The share of secured debt in our debt portfolio has dropped from more than 20 per cent of indebtedness four years ago to some 2 per cent as of the end of 2007.

As you see in the lower right diagram (Slide 6) over the last four years we have managed to maintain the average debt value on the level acceptable for the Company even despite the recent financial markets aggravation, which, as you know, is related to the bank crisis.

In 2007 we issued a number of new debt instruments in such currencies as Pounds Sterling and Japanese Yens. Thus, we have not only discovered new markets (the Asian and the British ones) but also increased the number of investors dealing with our debt instruments. Among the recent events I would like to point out the success of a diversified and considered approach while implementing our major projects pursuant to project financing principles. Gazprom's plans to actively introduce

project financing were discussed at the previous Press Conferences – now we can discuss a particular example.

Attraction of financial resources for project financing enables Gazprom to avoid additional risks and an increase in the Company's debt burden due to a large scale of the project. On July 16, 2008 loan documentation worth a total of USD 5.3 bln for a period of 12 years was signed. It took the shareholders more than three years of intensive work to complete the transaction. The Japan Bank for International Cooperation acted as the major creditor of the project financing totaling USD 3.7 bln. The rest of funds (USD 1.6 bln) were provided by a consortium of the largest Japanese and Western European commercial banks. The transaction doesn't provide for debt consolidation for the shareholding companies. The activities related to the Sakhalin II project financing enabled to deepen business relations with the leading financial institutions, authorities and non-governmental organizations in Russia, Japan and Western Europe. We consider the transaction unprecedented in terms of its complexity and scope since it sets new standards of large-scale investment projects financing both in Russia and globally.

The Russian market is a prioritized sales market for the Company in terms of actual gas volumes. Therefore, the processes initiated in Russia within the liberalization of the domestic gas market give an important impetus to the Company's value rise. The Government has adopted a decision to boost the dynamics of changing regulated wholesale gas prices up to 2011. A work is underway to develop market principles of natural gas pricing on the domestic market. Since 2007 the Russian Federation Government has introduced new methods of wholesale gas prices regulation for individual groups of consumers providing that such prices, within certain limits, are agreed between the suppliers and consumers.

Moreover, in 2007 an experiment on gas sales at deregulated prices via the electronic trading platform was successfully completed on a parity basis with

independent suppliers. Based on the annual results the price level at the electronic trading platform in 2007 exceeded the regulated prices by 35-37 per cent on the average. We consider it crucial that the Government approves the transition from the regulated wholesale gas prices to the regulation of transportation tariffs starting from 2011 and grants Gazprom the right to independently define wholesale gas prices for consumers (except for the population) under the formula based on equal profitability from the domestic and foreign gas supplies.

Taxation is a material factor influencing the current indicators and perspective development of the Company. I would like to emphasize that a decision was adopted at the top state level to secure a stable tax regime for the Mineral Production Tax in gas production up to 2011. Nowadays, Gazprom keeps elaborating proposals concerning the differentiation of the Mineral Production Tax in gas production by the maturity level, economic and geographic environment, as well as other conditions of gas fields development.

I would like to say a few words about the initiatives for the introduction of up-to-date information technologies as an efficient tool for executing our policy aimed at enhancing the transparency of financial and business activities, as well as improving the corporate management system. In January 2008 the Gazprom Management Committee adopted the Company's Informatization Strategy. The Strategy provides for establishing an integrated information space in Gazprom while securing vertical and horizontal integration of automated management systems. This will allow to consolidate data on all kinds of business and activities, and provide the support to business processes management at each and every management stage. Slide 9 shows the layout of a management reporting system. A corporate data bank serves as the information basis of the system. Creation of an integrated information space will provide for data unification and transparency of corporate reporting ranging from the initial information sources to the key efficiency indicators and the risks related to the Company's activities. To sum up the presentation, dear colleagues, and before proceeding to your questions, I would

like to emphasize that our achievements are highly esteemed in the market. From the beginning of 2005 Gazprom's market capitalization has grown more than four times, by the end of 2007 market capitalization reached peak values and made up over USD 300 bln. Thus, Gazprom became one of the largest energy companies in the world.

In 2007 Gazprom's credit ratings weren't revised. As of the end of 2007 the Company secured credit ratings on the investment level granted to it by three world's leading rating agencies in 2006. In April 2006 Fitch Ratings increased Gazprom's credit rating up to the "BBB-" level.

We believe that Gazprom possesses a considerable growth potential. First of all, Gazprom has the right to develop immense gas reserves which haven't received an adequate market evaluation yet. In addition, the initiated process of gas market liberalization in Russia is a significant factor in increasing the Company's capitalization and its operational and financial indicators. Dear ladies and gentlemen, thank you for your attention. Now my colleagues and I are ready to answer your questions if there are any. Thanks.

**QUESTION:** Pavel Kushnir, Deutsche Bank. Mr. Kruglov, could you make things clear. Who is controlling Gazfond at the moment? What is the extent of the shareholders' claims for the assets controlled by Gazprombank via Gazfond? I mean both direct and indirect control. The said assets include Gazprom-Media, Sibur and others.

**ANDREY KRUGLOV:** As for Gazfond, since the first quarter of 2007 it has been excluded from the Company's consolidated financial statements. Pursuant to the Russian Federation legislation in force, all the pension funds including Gazfond are subject to specific management rules.

As for the asset management, in particular Gazprom-Media and Sibur, it's difficult for me to comment since these assets don't fall under Gazprom's authority.

Speaking of Gazprombank, for instance, (as you asked rather a comprehensive question) I would like to say that such assets as Gazprombank and Gazfond do not fit into Gazprom's core business activities and Gazprom is consistently pursuing a non-core asset sales policy.

The same thing has happened to Gazfond and Sogaz and the same thing will happen to Gazprombank this year. A decision was taken to reduce the Gazprom's share in Gazprombank from 42 per cent down to 25 per cent plus one share. It means that we want to retain the blocking minority in the company. This is due to the fact that Gazprombank is the major clearing bank for Gazprom Group, it has a well-developed network of branches, Gazprom's subsidiaries and employees (individuals) are among the bank's clients. Therefore, we are still interested in preserving a certain degree of control over Gazprombank.

You asked about Sibur as well. At the moment, Sibur is controlled by Gazprombank which, as we have already mentioned, doesn't fit into Gazprom's core business activities. A decision was also taken regarding Sibur (a relevant information message was published by our Press Service) by the Board of Directors to coordinate with Gazprombank Group the sale of 50 per cent plus one share of the equity capital of Sibur Holding on April 30, 2008 to Hidron Holdings Limited. In case the deal on the purchase of 50 per cent plus one share is concluded, Gazprombank's share in Sibur will shrink to some 20 per cent.

Everything mentioned above is true for Gazprombank. Recently, a meeting of Gazprombank Shareholders has taken place. At the meeting the number of Gazprom's representatives in the bank's Board of Directors decreased to five persons only. That means we are consistently selling non-core assets.

**QUESTION:** Anastasia Lyrchikova, RBC. Could you name the amount of net debt forecasted for the end of 2008? Am I right to think that this year you are not planning to extend the Borrowings Program, attract new large loans including for the financing of new acquisitions, in particular, the Kovykta project?



**ANDREY KRUGLOV:** The Gazprom Borrowings Program totals RUB 90 bln equivalent to various financial instruments. At present, within the Borrowings Program implementation we placed Eurobonds worth USD 1.1 bln that is USD 700+400 mln.

The Borrowings Program implementation will depend on Gazprom's financial demands and the market situation. There is a phrase I conventionally use at any meeting with journalists and analysts when speaking of assets acquisition: the Company is not planning to acquire large assets so far, though, it is difficult to predict the emergence of assets that may potentially be attractive to Gazprom. Thus, once there is a reason to reveal such information, we will certainly let you know. Currently, we don't have such plans.

As for the Kovykta project (my colleague Alexander Medvedev has also mentioned it during his Press Conference and I spoke about it last year, the same question was asked: Can any additional borrowings be expected?), for the time being, we assume that no additional borrowings are needed to conclude the transaction. As for the contractual terms, we (the Finance and Economics Department) are ready to make payments as soon as the other party to the negotiations and our colleagues are ready for that. I have nothing to add here.

**SERGEY YATSENKO:** Today, the net income of the parent company accounts for some USD 37 bln and about the same amount is expected as of the end of year. If Gazprombank is deconsolidated by the end of 2008, the debt will respectively decrease to USD 6.5 bln.

**MODERATOR:** I will quote a question received via the Internet. Investment analysts wonder what EBIDTA profitability indices are projected for the next three years?

**ANDREY KRUGLOV:** For the next three years the profitability is expected to amount to some 30-35 per cent.

**MODERATOR:** Interfax Agency: Will the share redemption program continue? As far as I understand, the question is about the share option program.

**ANDREY KRUGLOV:** As for the share option program and share acquisition, a relevant scheme has been developed, the amount of finance is defined and the share option program implementation mechanism is established as well. Therefore, it will be implemented in full conformity with the approved limits – neither more nor less.

**QUESTION:** Alexey Grivach, Vremya Novostey Newspaper. Actually, could you tell us how many positions on the Board of Directors of the Fund are occupied by the Gazprom representatives now? Is Mr. Alexey Miller still the Chairman of the Fund’s Board?

**ELENA VASILIEVA:** Today, heads of Gazprom’s subsidiaries prevail in the Board (5 out of 13 positions). The composition of the Board hasn’t changed.

**QUESTION:** RBC Agency. I have a question about the share option program of Gazprom Neft, but not Gazprom. As I see it, Gazprom is likely to make a decision to launch the share option program for the Gazprom Neft management. Have any respective proposals been submitted yet? What will the scope of the program be?

**ANDREY KRUGLOV:** Despite the fact that Gazprom Neft is an independent entity, Gazprom controls the bulk of Gazprom Neft’s equity capital. Of course, the decision concerning the share option program of Gazprom Neft will be taken at the meeting of its Board consisting mainly of the Gazprom representatives.

Currently (this issue has been addressed by the Gazprom Neft management), the average salary paid in Gazprom Neft and the average salary paid throughout the industry are somewhat different. In this regard, we are interested in saving the human resources available in Gazprom Neft; preventing the “skills drain” of highly qualified specialists and, undoubtedly, inspiring the Gazprom Neft management and employees in the intensive development of the company. Thus, the proposals

related to the share option program have been received. They are currently being considered by Gazprom's structural units: first of all, the Staff Management Department and the finance and economics units.

**QUESTION:** Lucian Kim, Bloomberg Agency. My question relates to the strategic area. We were told at the Press Conference last week that Gazprom intended to spend up to RUB 10 trln on new projects by 2020. From what sources is the Company going to take or attract such funds?

**ANDREY KRUGLOV:** The expenditures and the Investment Program for the next three years will actually be available for discussion once they are adopted. We are planning to submit the triennial Budget for 2009 through to 2012 as soon as this year. Primarily, I would like to inform you that we have adjusted the debt level and EBIDTA rate versus net income for the strategic targets. They will be maintained in any case. This is the first thing.

Secondly, where to get the sources of finance? It is a typical question and the answer will be typical as well. We will use the own and attracted funds.

Speaking of the exact amount – let it be RUB 10 bln or not – it's too early for a discussion. The exact amount has not been approved by the Management Committee and the Board of Directors so far. We can only speak about the expenses that have undergone approval in line with the corporate procedures, that is, about the Budget for 2008.

**QUESTION:** Vremya Novostey Newspaper. I've got two questions to ask, if you don't mind. Will the Investment Program be amended? If I'm not mistaken, Mr. Alexey Miller said that it would be expanded as early as the current year.

The second question is related to Gazprom Neft share option. Will the shares be redeemed this year? As far as I understand, the option expires in April 2009. Are you going to make this deal in 2009 and what is the price?

**ANDREY KRUGLOV:** As for the Investment Program, I'd like to say that we are traditionally adjusting the Budget for the half-year results. The documents have been submitted to the Management Committee and undergo revision. In line with the changes in scenario terms that have been made since December 2007 (these are, first of all, the USD exchange rate and the gas price for non-CIS countries), the major Budget items will definitely be amended including the Investment Program items.

It is early to name any exact figures until the Management Committee approves the amendments to the Budget but we suppose that the Investment Program for 2008 will be expanded if compared to the edition approved in December 2007. The difference will average RUB 100 bln. You have also asked about the Gazprom Neft share option, haven't you? You are right, the option expires in 2009 and, that has also been mentioned many times, Gazprom is planning to redeem this option, that is, it plans to consolidate the remaining Gazprom Neft shares in the amount of some 20 per cent. Pursuant to the agreement, the process termination is scheduled for April 2009. The option will have been sold by that time.

**QUESTION:** At what price?

**ANDREY KRUGLOV:** About USD 4 bln.

**MODERATOR:** If there are no questions, the Press Conference is over. Thank you.