Press Conference

Gazprom in Eastern Russia. Entry into Asia-Pacific Markets

June 14, 2016

MODERATOR: Good morning, colleagues. We continue the series of Press Conferences in the lead-up to the annual General Shareholders Meeting. Today, we will address Gazprom's projects in eastern Russia and its entry into the Asia-Pacific markets.

Taking part in the Press Conference are:

– Vitaly Markelov, Deputy Chairman of the Management Committee;

– Alexander Medvedev, Deputy Chairman of the Management Committee;

– Oleg Aksyutin, Member of the Management Committee, Department Head;

– Vyacheslav Mikhalenko, Member of the Management Committee, Department Head;

– Vsevolod Cherepanov, Member of the Management Committee, Department Head;

– Pavel Oderov, Department Head;

– Elena Burmistrova, Director General of Gazprom Export.

Let's proceed as follows: first, Mr. Vitaly Markelov will deliver an opening speech, then Mr. Alexander Medvedev will take the floor, and after that we will turn to questions.

VITALY MARKELOV: Good morning, esteemed colleagues. First of all, I would like to note that Gazprom is consistently developing its projects in the eastern part of our country. We created a gas industry in eastern Russia within a short period of time. Looking back at our milestones, I can single out Sakhalin II in 2009, gas supply to the Kamchatka Territory in 2010, commissioning of the Sakhalin – Khabarovsk – Vladivostok gas pipeline and gas supply to the city of Vladivostok in 2011, commissioning of the Kirinskoye gas and condensate field and the commencement of construction of the Power of Siberia gas pipeline in 2014, and the start of the Amur gas processing plant construction in 2015. All those projects are currently evolving and a lot needs to be done in the near future, including the expansion of capacities in Sakhalin and Kamchatka and the facilities to be used for gas supply into the Power of Siberia pipeline.

ALEXANDER MEDVEDEV: Good morning, dear members of the media. The importance of today's topic is evidenced by the fact that it is the only Press Conference attended by seven of Gazprom's top executives. As a Far Eastern native, I am particularly pleased to be in the company of people who do the utmost to help this region develop. As Mikhail Lomonosov said: "The wealth of Russia will grow through Siberia." Through Siberia and the Far East, one might add. It's a unique project where exploration, production, construction of gas transmission and processing capacities, and marketing are carried out simultaneously under coordinated schedules.

QUESTION: Anastasia Goreva, Argus Media agency. Does the ongoing front-end engineering design for the third train of Sakhalin II provide for using the Kirinskoye field's gas resources and Sakhalin II's resources? If so, at what stage?

My second question: why haven't Gazprom and CNPC yet started to negotiate the price for natural gas that will be supplied via the western route, Power of Siberia 2?

My third question: is there a possibility of exporting pipeline gas via the Sakhalin – Khabarovsk – Vladivostok pipeline after extending it to China? What is the progress with the discussion of the memorandum signed in September by the Chinese company and Gazprom on exporting pipeline gas from Sakhalin?

ALEXANDER MEDVEDEV: The fact is that FEED is going according to schedule, and we are considering several gas supply options, including the Kirinskoye and Yuzhno-Kirinskoye fields.

The second option is Sakhalin I, where we are still in talks on possible gas purchases.

As for the resource base of Sakhalin II, had it been large enough, the third stage would have been completed long ago. Unfortunately, we are short of gas. Moreover, eventually – not very soon, but still – we will have to replenish the Sakhalin II resource base in order to sustain the production rate of 10 million tons.

ELENA BURMISTROVA: We are currently negotiating both commercial and technical parameters of gas supplies via the western route with CNPC. The gas price is just one aspect of the commercial terms. Of course, we're discussing it, too.

ALEXANDER MEDVEDEV: Colleagues, price loves silence. Otherwise it may suffer.

Speaking about the memorandum we signed and the opportunities for gas supplies from the Far East – the Sakhalin production center – we are at the initial stage now, discussing the technical and economic conditions of such supplies. The most important factor is demand, as the changes in growth rates in China have inevitably influenced gas consumption forecasts. Another lingering issue is the future of coal-fired power generation in China despite the pollution level caused by CO_2 emissions, which is dangerous both from the international point of view and, most importantly, in terms of health risks for Chinese citizens, with tens – if not hundreds – of billions of dollars spent annually on medical treatment and disability compensations. However, the final decision has to be made by the Chinese party. We believe that China will make this choice eventually, and its gas consumption will double and keep on growing.

QUESTION: Vitaly Sokolov, Energy Intelligence agency. What is the amount of gas supplies negotiated for the western route? A CNPC representative recently said that he couldn't confirm the amount of 30 billion cubic meters per year. Was that amount fixed in the provisional agreements signed last year? If it was, did your Chinese partners approach you later to revise it?

ELENA BURMISTROVA: As you have correctly pointed out, we signed the Heads of Agreement last May to supply gas via the western route in the amount of 30 billion cubic meters per year. No changes have been made to the agreements since then.

QUESTION: Evgenia Sokolova, TASS agency. Chairman of the CNPC Board of Directors said recently that there would be different prices for gas supplies via the eastern and western routes, but he gave no details. Could you please specify the parameters the Chinese party is guided by, as well as the possible differences?

ELENA BURMISTROVA: As you know, sellers and buyers always have two different goals: the former want to sell high and the latter want to buy low. So it's natural that each company has its own vision of the situation. We are currently discussing the commercial and technical parameters of gas supplies that were outlined, as I have already mentioned, in the documents signed earlier. It would be premature to make any definite statements at this point.

ALEXANDER MEDVEDEV: Colleagues, you've been writing about natural gas and its marketing for a long time. Here's the thing: unlike the western route, the eastern route's entry point is 4,000 kilometers away from the Russian-Chinese border. Clearly, this transmission factor cannot be overlooked. This is why the prices at delivery points can never be equal.

QUESTION: Elena Mazneva, Bloomberg agency. Considering that this year's scope of construction for Power of Siberia is 400 kilometers and you have already built 115 kilometers, what plans do you have for 2017 and 2018? Does it mean that you will have to complete over 1,000 kilometers each year? Have you already estimated future costs?

Concerning the western route: yesterday, Interfax quoted a source from the CNPC leadership as saying that China was proposing a packaged deal for the western route. The deal is about joint production, construction and operation of the gas pipeline. Have you received any such proposals? Is Gazprom considering them? Would you accept such a deal?

When will you finally sign the western route contract? Do you have any projections?

VITALY MARKELOV: Indeed, we said last time that we were going to build 400 kilometers of the Power of Siberia gas trunkline. Stroytransgaz is currently maintaining three process flows. We should have 17 process flows before the year's end. The other contractors are mobilized and will start working in June. We are not changing those plans, and I think we will achieve the goal of building 400 kilometers this year. The remaining linear part, in its turn, should be completed in the subsequent years. And our financial resources will be redistributed with respect to the remaining part.

ELENA MAZNEVA: In order to commission the pipeline in 2019, what plans do you have for 2017 and 2018 in terms of funds and length? Or will you postpone it until 2021 as the contract allows?

VITALY MARKELOV: No, we haven't changed the plans. They are still the same: construction in 2018 and gas supply in 2019.

ALEXANDER MEDVEDEV: Do you doubt that we can build 1,000 kilometers per year? You should visit one of our volunteer cleanups and see our people at work. You'll see that it's feasible.

As for the packaged deal on the western route, unlike some Russian companies that implement the whole scope of their projects jointly with their foreign partners, including Chinese ones – just look at Yamal LNG – we did not and will not change our approach. We only allow foreign partners to participate in Russia-based production projects under the condition of a strategically beneficial swap of assets that are equivalent in value. Preferably with exploration and production assets.

If we look into the past, some time ago there were talks about both Gazprom and Shell taking part in the China-based West – East project. The Chinese party rejected that idea. We revisited it later, pointing out the possibility of using Russian resources. Again, we failed to reach an agreement for understandable reasons, which are basically the same everywhere.

So, if you see press reports saying "let's cooperate on the western route across the whole chain," we know nothing about that and we don't support that approach.

ELENA BURMISTROVA: I'd like to add that there is a number of documents, including intergovernmental ones, that were signed in 2015. The companies act according to the documents they signed and the agreements they entered into as a result.

ELENA MAZNEVA: When do you expect to sign the final contract? You gave different dates in several forecasts, and then you stopped making forecasts altogether.

ELENA BURMISTROVA: We will hold a number of follow-up meetings at the St. Petersburg International Economic Forum. We also have a visit to Beijing scheduled for late June. After that, we will probably be able to give you a more precise forecast.

ALEXANDER MEDVEDEV: For ten years, I kept predicting the contract would be signed before the year's end, and it didn't happen. This is why we have become more cautious with predicting the signing date, especially because, as they say in China, you work for 100 years and then you're happy for 1,000 years.

QUESTION: Sofia Dvornik, RIA Novosti. I have a question for Mr. Markelov. I would like a clarification about the contracts for the construction of Power of Siberia from Chayandinskoye to Blagoveshchensk. Have all of its sections been contracted out?

VITALY MARKELOV: By now, all contracts for the construction of the linear part have been signed.

SOFIA DVORNIK: Could you please tell us who is constructing the sections from Lensk to the

Amginskaya CS and from the Nimnyrskaya CS to Belogorsk?

VITALY MARKELOV: The Nimnyrskaya CS – Belogorsk section is built by Stroygazmontazh. Stroytransgaz is responsible for the first section you've mentioned.

QUESTION: Dmitry Bandura, Nikkei newspaper. A question for Alexander Medvedev. You said that additional resources would be needed to sustain the production rates at the LNG plant of the Sakhalin II project. When do you expect it to happen and what is the potential production decline if you don't use additional resources?

ALEXANDER MEDVEDEV: It's about long-term prospects, 15 to 20 years into the future. We have no problem with maintaining the productivity of the two trains of Sakhalin II within the next 15 to 20 years. As you know, we are even exceeding the design capacity by approximately 1 million tons per year. Considering how long the plant has been in operation – we launched it in 2009, so seven years have passed and 20 years are ahead, which makes it 27 years – all in all, it's possible to recover both production and amortization costs during that period.

QUESTION: Stanislav Toropilo, first Arctic TV channel Yamal-Region. It's well-known that LNG projects are among the key trends in the national hydrocarbon industry. What do you think of Gazprom's ambitions in this area in the short and long term? What is being done to make us the leaders in the market? Who is our main competition in today's global market?

ALEXANDER MEDVEDEV: You are correct: LNG projects are among our strategic priorities, which is why we are expanding Sakhalin II through the third production train, while Baltic LNG will have two, maybe even three or four trains. That's because there are no business or production risks there and gas will be provided by the Unified Gas Supply System of the Russian Federation. We know how to deliver gas to the northwestern region. We'll supply gas not only to Baltic LNG, but also to Nord Stream 2 and to the expanding gas infrastructure of northwestern Russia where gas demand is growing. The balance has been drawn up and works are underway. There is also a possibility of creating two trains within the Baltic LNG project by 2021.

Still, the LNG market development is not a goal in itself. We need that flexibility to redistribute gas flows. On the other hand, we should not forget about LNG's competitiveness compared to pipeline gas. This is why we consider pipeline gas and LNG exports to be a promising combination. We have large-scale and small-scale LNG shipments on the agenda. We are already running several small-scale LNG projects. We are also looking into new projects in the Baltic and Black Seas. We have the required technologies, including those with a wide use of Russian equipment. Quite recently, we talked about that at the meetings of the Management Committee and the Board of Directors. We received their approval and we'll work further.

Competition? Many say that U.S. LNG is a competitor to Russian gas in Europe. I disagree with that and I've tried to get my point across, but they just ignore me. Everyone – not only Americans, but also the European media – gleefully wrote about how Portugal and Europe at large were going to meet the first LNG carrier from the United States. I said it once, I said it twice, but there was no response. Let's be honest and write where the first U.S. carrier went. It didn't go to Europe! American businessmen are no fools, they know how to count money and find a more profitable destination for an LNG carrier. One could make them reconsider, of course. One could imagine that under pressure they would have to supply LNG, lose money and go bankrupt in the end. Meanwhile, our gas has no competitors, especially in view of the national currency devaluation. It has no competitors at all. That's what I can tell you.

ANASTASIA GOREVA: Will you have to use other resources of Sakhalin II in addition to the Lunskoye field in order to sustain gas production rates for 15 to 20 years? There are still some unexplored areas where no production operations have been carried out. It was a matter of debate whether they should be tapped for that purpose. Have you decided to develop them or not?

Mr. Medvedev, you said several years ago that you gave priority to eastern LNG projects, but now you're saying that LNG is not a goal in itself. We know that Sakhalin II contains additional gas resources and not all of them will be used for the third train of the LNG plant in Sakhalin. Are they meant for the fourth train or is it better to deliver that gas via a pipeline? Has your strategy changed or not?

ALEXANDER MEDVEDEV: Follow-up exploration is underway within Sakhalin II. The data obtained earlier are being processed. The decision on the feasibility of developing those resources will be based on the exploration results.

PAVEL ODEROV: We'll use the resources if we find it cost-effective to develop them. The resources that can be developed are there. They lie deeper. They are more expensive to develop than the ones we're accustomed to. So, if they are proved to be cost-effective, they will be added to the project perimeter and developed.

ANASTASIA GOREVA: Do you take the Lunskoye field into account when speaking about those 15 to 20 years?

PAVEL ODEROV: Let's put it this way. We have contracts for LNG supplies. The contracts are fully covered by the resources of the producing fields. Not all of these contracts are meant for 15 to 20 years – some of them will expire earlier. But until then, the contracts are fully covered by the resource base. We will certainly start developing the deep-lying formations if it turns out to be cost-effective. Accordingly, it will extend the operating life of the LNG plant through the resources of the Sakhalin II project.

QUESTION: When will the decisions be made?

PAVEL ODEROV: There is no urgency yet, as the existing reserves are sufficient for the contractual obligations to be fulfilled for at least ten years.

ANASTASIA GOREVA: Concerning LNG and pipeline gas…

ALEXANDER MEDVEDEV: This applies not only to the Far East, but also to the strategy in general, including Baltic LNG. There is also Vladivostok LNG, but it's postponed for now. And looking into the future, we have Shtokman. Technologies are constantly evolving and I am sure that the time of Shtokman will come, hopefully in the lifetime of this generation of Russians.

ANASTASIA GOREVA: I meant gas from Sakhalin. Is LNG or pipeline gas your priority at the moment?

ALEXANDER MEDVEDEV: At the moment, our top priority is the third train of the LNG plant within Sakhalin II.

ANASTASIA GOREVA: And what will you do after that?

ALEXANDER MEDVEDEV: Let's not get ahead of ourselves. We'll finish this first and then we'll go further. The potential for demand is there. Our Japanese colleagues keep requesting that we get back to the project for pipeline gas supplies to the island of Hokkaido. So we do have buyers.

DMITRY BANDURA: Since you've mentioned your Japanese colleagues, do you have any specific information concerning pipeline gas supplies to Hokkaido?

My second question: at this stage of the project for the third train of Sakhalin II, do you have an understanding as to your future partners for the project? Will there be any? If so, what are the most promising options and on what terms will you cooperate? Is it going to be contracting work or something else? What is your vision at this stage?

ALEXANDER MEDVEDEV: There is nothing new with the project for pipeline gas supplies to Japan, except for the fact the Japanese party has once again confirmed its interest. We will probably take another look at the pros and cons of this project if necessary.

As for the third train, the project is implemented by Sakhalin Energy under the Production Sharing Agreement, with the sole exception that gas will be supplied by Gazprom. There has been no other option so far.

QUESTION: Jack Farchy, Financial Times newspaper. What is the current projected value of Power of Siberia and the Eastern Gas Program as a whole, taking into account the Chayandinskoye and Kovyktinskoye fields?

My second question: does Gazprom plan to continue financing the Program with its own funds or to secure debt financing from Chinese or other banks operating in the capital market?

VITALY MARKELOV: We don't disclose the value of our contracts.

ALEXANDER MEDVEDEV: You know, it would be unnatural to finance everything from our own resources despite the complex situation in the financial markets and the sanctions regime that is still in effect. I would like to point out that the French Parliament has voted by an overwhelming majority to lift the sanctions, because, apparently, quite a few of French MPs are smart people capable of assessing the political and economic consequences of sanctions for us and for them. Their decision is a recommendation, so we'll look at the results of their next meeting. There are good examples: say, Yamal LNG is attracting Chinese financing.

QUESTION: Maria Tatevosova, Rambler agency. We've talked about Power of Siberia's construction in 2016. Could you please inform us of the construction plans for 2017? You're planning to build 400 kilometers this year. What about the rest?

VITALY MARKELOV: This July, we'll start reviewing the investment program for the next year. So, we will discuss those issues very soon.

MARIA TATEVOSOVA: Could you at least specify in percentage terms, will you build 'not less' or 'more'?

VITALY MARKELOV: More than this year.

ELENA SOKOLOVA: You've already mentioned that you have resumed your negotiations with Rosneft in order to buy their gas from the Sakhalin I project. Have they changed their mind? Before that, they planned to use that gas for their own LNG plant. Are they more open to dialogue now?

My second question is about the Amur GPP. What is the progress with it? Will you be able to meet the schedule? Has there been any slippage?

ALEXANDER MEDVEDEV: Do you mean Rosneft wasn't open to dialogue before? We've been in talks for a long time. Potentially, gas could be supplied by Rosneft, if it buys gas from Sakhalin I, or directly from Sakhalin I, which is operated by Exxon Neftegas Limited, by the way. That's why Sakhalin Energy has contacts with Sakhalin I. We hold informal consultations with Rosneft. There is no doubt that they are open to dialogue. I think it will be more profitable for Rosneft if we jointly work out a price formula in line with the Sakhalin I development schedule. I believe it will be mutually beneficial. So, if our talks are not about fame but money… And as for fame, we'll come to terms about it in the end.

VITALY MARKELOV: Regarding the Amur gas processing plant, its construction is on schedule. The project is run by NIPIgazpererabotka, a subsidiary of SIBUR. Today, around 30 companies are involved in the project. They are engaged in land planning and the construction of railroads and a temporary mooring on the Zeya River. A field meeting was held quite recently to review the project's status. We had a look at the work process on the spot. This year, we're starting the construction of the pile foundation for the main process equipment that will be supplied by Linde. So, we're on schedule. Construction is funded through project financing.

QUESTION: Alyona Makhneva, Vedomosti newspaper. What amounts are you negotiating with Rosneft?

ALEXANDER MEDVEDEV: We are negotiating the entire amount they can produce.

QUESTION: Varvara Kulaeva, Interfax agency. Have you already interpreted the drilling results for the seventh and eighth wells at the Yuzhno-Kirinskoye field? What additions do you expect there?

VSEVOLOD CHEREPANOV: Last year, we completed the drilling of the seventh and eighth wells. All data have been obtained and interpreted; desktop studies have been finished. Moreover, the results have been submitted to the State Reserves Commission. We added 216.3 million tons of fuel equivalent to our reserves. Accordingly, Gazprom currently has 711 billion cubic meters of gas and 111 million tons of condensate at the Yuzhno-Kirinskoye field.

QUESTION: Vladimir Soldatkin, Reuters agency. Last year, you sold 3 million tons of LNG from your portfolio. How much do you plan to sell this year?

Do you have forecasts for LNG imports in China for the next years and for the medium term?

ALEXANDER MEDVEDEV: Colleagues, you have correctly pointed out that Gazprom's LNG portfolio includes supplies from Sakhalin II and other sources based on medium- and short-term market transactions. We are not going to lower that level; we plan to sell 3 million tons. If we sell more, so much the better. We have a sizable LNG portfolio that can and will grow further.

As for China, you'd better ask the Chinese. We study all analytical sources, of course. You know roughly how much LNG they buy every year and how much they obtain through spot deals. Today's market is unstable, which is why spot prices are fluctuating as opposed to long-term contract prices. But we are monitoring the situation very closely. We can be flexible with supplies. So if you think that only Americans can reroute their supplies, you are mistaken. We, too, can redirect them whenever the contract terms allow. There's nothing wrong with that.

QUESTION: Timofey Dzyadko, RBC newspaper. Mr. Medvedev, you've said that Russian gas has no competitors due to the devaluation of the national currency. Has the price for China and the total value of the contract changed as a result of the devaluation? It was USD 400 billion in May 2014. Has the price remained the same or has it changed?

ALEXANDER MEDVEDEV: The contract value hasn't changed, because the forecast value of the contract was based on forecast prices, not the then-current prices. And we are always very conservative in our forecasts.

Speaking about prices, colleagues, I don't remember who alleged that Gazprom engaged in dumping, selling gas 20 per cent below the market prices. The reports were about an upsurge in spot and forward prices, with Gazprom selling gas at a 20 per cent discount.

Let me remind you once again that our export portfolio is made up of several types of contracts. The first type is based purely on spot prices. The second type is a hybrid between spot and petroleum factors. And the third type is pegged solely to petroleum products. You know how the oil price changed over time. That affected the petroleum component. Spot prices were falling throughout the whole year, essentially since February. Eventually, they started to rise. The media saw it like this: there was the spot price and there was Gazprom's price – a forecast price set a month before – so, apparently, Gazprom had no choice but to give a 20 per cent discount.

We don't give any discounts. Our export portfolio operates the way I described, generating specific prices. So, at the risk of disappointing you, we don't engage in either dumping or discounts, no matter on what terms – economic or geographic – we never do that. We have a system of long-term contracts, which is now complemented by gas auctions. I think we will announce another auction for Western Europe soon, maybe in June, in consideration of your reminder that we sell gas at a discount. From now on, we won't give discounts.

ANASTASIA GOREVA: Could you please tell us the approximate percentage of spot, hybrid and oil-pegged contracts in your export portfolio? Will it change depending on today's market conditions?

Speaking of the entry into Asia-Pacific markets: will the current market conditions affect your negotiations with Asia-Pacific countries? Are you going to conclude hybrid contracts or something similar? Is that at all possible?

ALEXANDER MEDVEDEV: Colleagues, this issue is beyond the scope of today's Press Conference. Moreover, I have already talked about the structure of our portfolio. If you want to catch me out contradicting myself, that won't happen. So let's drop this subject.

As for liquid hubs in Southeast Asia, there aren't any right now. They are trying to create them in Singapore, but creating an index is one thing and creating a liquid hub is another. Considering how dispersed the sources are, I think it's unrealistic. Although you can create any index you want.

ANASTASIA GOREVA: That's true, but the gas supplied to Asia-Pacific is already pegged to spot prices or to Henry Hub, for instance. Do you mean you are not going to take the current market conditions into account during the negotiations?

ALEXANDER MEDVEDEV: In two or three years, we will sell gas at the St. Petersburg gas exchange.

MARIA TATEVOSOVA: You've said you will review the investment program for the next year in July and there will be negotiations in China in late June. We've already asked you about shifting the construction completion deadlines for Power of Siberia. Will you discuss that issue in China? Since, according to our colleagues, the demand in China has weakened, could this issue be on the agenda already?

Mr. Medvedev, could you please clarify about the four trains of Baltic LNG: how much is that in total?

ALEXANDER MEDVEDEV: It's 20 million tons.

VITALY MARKELOV: We discuss the progress of the Power of Siberia project with our Chinese partners constantly, at our Coordinating Committee meetings and during the last talks, too. It's a recurring subject. Our Chinese partners have confirmed that the pipeline construction is to start this year. So, we work in a synchronized manner. With our work groups, we keep track of the work progress both in Russia and in China. Accordingly, we should complete the gas pipeline simultaneously. This is an issue not only for Gazprom, but also for the Chinese company.

MARIA TATEVOSOVA: They haven't raised that issue?

VITALY MARKELOV: No, they haven't.

SOFIA DVORNIK: Another question for Mr. Markelov. Do you already know how much gas can be supplied by Power of Siberia for the gasification of the Far East?

VITALY MARKELOV: The Power of Siberia gas pipeline runs across two regions of our country – the Republic of Sakha (Yakutia) and the Amur Region. We estimate gas consumption in those two regions to be around 2.5 billion cubic meters of gas overall. The Power of Siberia pipeline will convey gas to those regions.

SOFIA DVORNIK: So, it's reasonable to assume that if the pipeline's export capacity makes up 38 billion cubic meters plus 2 billion cubic meters for the regions, the total capacity of the gas pipeline will amount to 40 billion cubic meters.

VITALY MARKELOV: We will expand the capacity of our gas pipeline in parallel with the ongoing gasification. I mean, it's a time-consuming process. It takes time to design and build gas distribution networks and prepare assets for gasification, which is why we will also expand our gas supply facilities at the same time. The first of our planned gas supply facilities will deliver gas to the Vostochny spaceport; we have started to design that gas pipeline. To that end, we're cooperating with the company focused on the gasification of Vostochny.

MODERATOR: Thank you. The Press Conference is over.