NAFTOGAZ GROUP

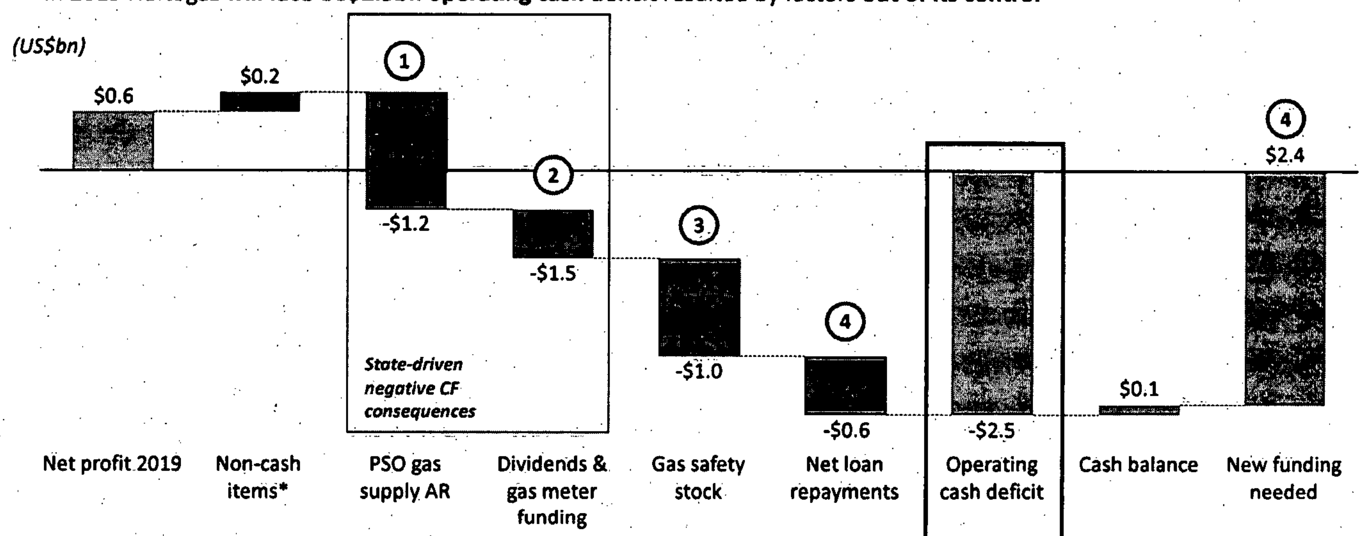
2019

Naftogaz Group
2019 funding gap considerations

26.04.2019

DUE TO FACTORS OUT OF NAFTOGAZ CONTROL COMPANY IS FACING US$2.5BN DEFICIT IN 2019

- ✓ During last three years **Naftogaz is profitable** and **stopped receiving any support** from the budget
- ✓ During last three years **Naftogaz** became one of the **key contributors to the budget**
- ✓ In 2019 Naftogaz **will face US$2.5bn operating cash deficit** resulted by factors **out of its control**



• *Non-cash items includes depreciation, doubtful debt and legal provisions, other*

NAFTOGAZ INCURS NEGATIVE CASH OUTFLOW OF US1.7BN FOR CARRYING OUT STATE-IMPOSED OBLIGATIONS AND PAYOUTS

1 PSO gas supply accounts receivable increase

- ✓ Naftogaz is obliged to perform ***PSO obligation to supply natural gas*** to the ***specific regional gas supply companies and district heating companies*** for the needs of households ***at fixed price***
- ✓ Naftogaz supplies gas ***on post-payment basis*** allowing companies ***to increase its debt*** to Naftogaz (in particular due to ***below 100% collection and delays in payments***)

1 UTG balancing services AR increase

- ✓ Regulator-approved Network Code obliges Naftogaz's Ukrtransgaz to ***balance the system*** in case of deficit caused by ***unauthorized offtakes by consumers*** through procuring negative gas balance volume
- ✓ No effective collection mechanism leading to ***US1.2bn balancing indebtedness as of year-end 2018*** and expected increase by additional ***US$0.5bn by the end of 2019***

2 Dividends & obligatory gas meter costs

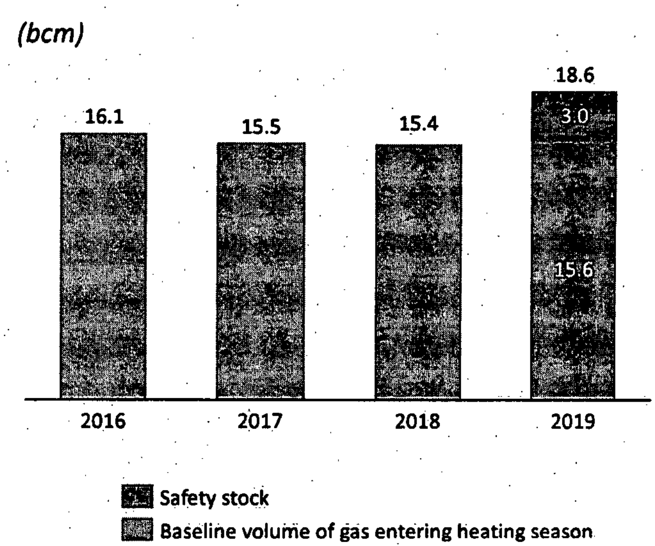
- ✓ Government extracts most of Naftogaz profit through dividends further limiting its ability to invest in growth and modernization
- ✓ In 2019, Naftogaz is to pay out ***90% of 2018 net profit*** or ***US$0.5bn*** in direct dividends. In addition to that, Naftogaz was ***obliged to finance the state household gas metering device installation program*** resulting in additional expense of ***US$0.1bn***

TO SECURE HEATING SEASON AND HEDGE AGAINST POSSIBLE SUPPLY DISRUPTIONS, NAFTOGAZ HAS TO PRODUCE ADDITIONAL 3BCM OF GAS

(3)

- ***In 2017-2018 - with current transit contract in place*** - Naftogaz needed ***~15.5bcm*** in underground gas storage entering the heating season
- ***Possible termination of transit starting from 1.01.2020*** may cause ***deficit*** in some Eastern European countries and result in ***inability for Ukraine to import gas*** during heating season
- To hedge against such risk, Naftogaz needs to accumulate ***"safety stock" of additional 3 bcm*** in storages to secure ***safe 2019/2020 heating season***

Naftogaz' gas in storage entering heating season volume



THE ONLY SOURCE TO SUSTAIN THE COMPANY TILL THE END OF 2019 IS RAISING NEW DEBT IN THE AMOUNT NOT LESS THAN US$2.4BN

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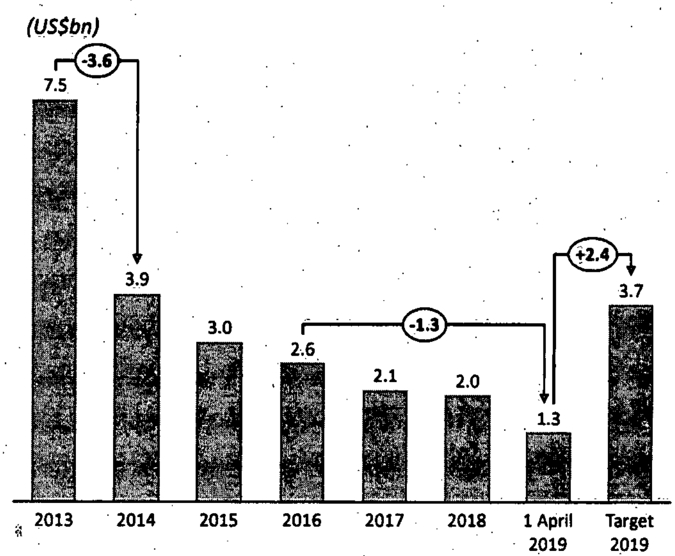
- ✓ Since 2013, Naftogaz has significantly decreased its loan portfolio to **historical minimum of US$1.3bn** in April 2019
- ✓ Given limited ability in market fund raising, ***Naftogaz relied upon loans from IFIs since 2014 (EBRD, WorldBank)***
  Tenors of these loans were 3-4 years and Naftogaz has repaid (or in the process of repayment) all of them
- ✓ ***Due to lack of reform*** implementation progress by the Government, ***IFIs are not willing to continue loan extension or issue new loans***
- ✓ ***The only source*** to sustain Naftogaz till the end of 2019 is ***raising new debt*** on the amount not less than UAH64bn or ***US$2.4bn*** (including possible issue of Eurobonds for US$0.5-1bn)

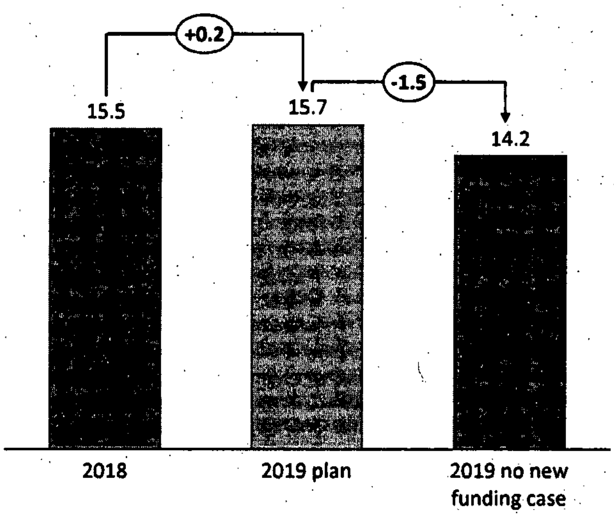
Naftogaz' loan portfolio evolution



If no new loans, Naftogaz will have no funds to pay its upstream subsidiary Ukrgasvydobuvannya for supplied gas that in turn will have to drastically cut its upstream CAPEX

NAFTOGAZ GROUP UPSTREAM PRODUCTION PROGRAM IN 2019 RELIES HEAVILY ON NEW FUNDING AVAILABILITY

Ukrgasvydobuvannya production volume (bcm)

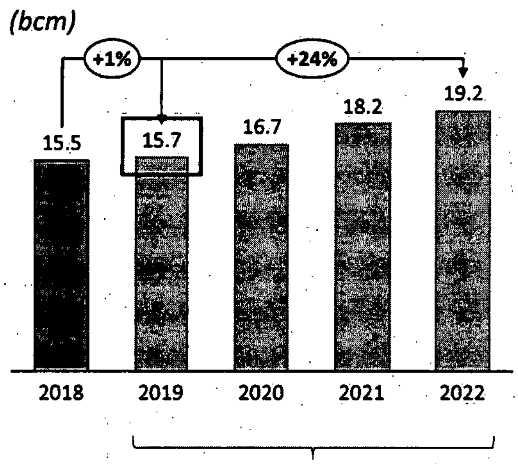


- ✓ If no new loans are raised during 2019, Naftogaz will have ***to significantly decrease upstream CAPEX program*** resulting in ***drastic decrease of production level***
- ✓ *Producing 75% of domestic gas, Naftogaz created demand for services of* ***international contractors (Halliburton, Weatherford etc)***, who **will leave Ukraine** in case of investments decrease
- ✓ The resulting drop in production is likely be up to ***1.5bcm*** vs. current plan which will have to be replaced by imports at total cost of ***US$0.3bn***

Underfinancing production program launches a vicious spiral of having to import gas to cover production gap, further increasing deficit

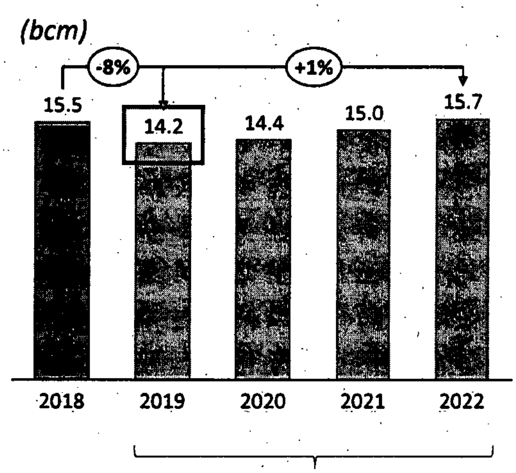
IF HEAVILY UNDERINVESTED IN 2019, NAFTOGAZ PRODUCTION WILL ONLY BE ABLE TO GET TO CURRENT 2019 TARGET AS LATE AS IN 2022

Current Naftogaz business plan of 15.7bcm production in 2019...



Cumulative production of 70bcm

...will reduce to 14.2bcm in case of no new funding available



Cumulative production of 59bcm

CONCLUSIONS

The dire funding situation Naftogaz has found itself in is primarily the result of

- ✓ Government-driven value destructive action or non-action
- ✓ Risk of zero transit and "gas wars" in Q1 2020

NAFTOGAZ needs to raise US$2.4bn of new loans

- ✓ to ensure that Ukraine will not freeze out during Q1 2020
- ✓ to secure own gas production growth and energy security