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PRESENTATION

Operator

Good day. And welcome to the NOVATEK Third Quarter 2018 Financial Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mark Gyetvay. Please go ahead, sir.

Mark Anthony Gyetvay - *PAO NOVATEK - Deputy Chairman of the Management Board & CFO*

Okay. Thank you very much. Ladies and gentlemen, shareholders and colleagues, good evening, and welcome to our third quarter and 9 months 2018 earnings conference call. I would like to thank everyone for taking their valuable time to join us this event on tonight's conference call.

Before we begin with the specific conference details, I would like to refer to you our disclaimer statement as it is our normal practice. During this conference call, we may make reference to forward-looking statements by using words such as 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 at 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 the 31st of December 2017, as well as any of our press releases and documents throughout the past year for more descriptions of the risk that may influence our results.

The oil and gas industry is expected to report solid financial results this quarter aided by continued strong commodity prices underpinned by stronger than expected demand, tighter supplies and geopolitical uncertainties. We are no exception. We had an exceptionally strong third quarter and 9 months as the macro environment supported our increase in volumes of LNG produced from our flagship Yamal LNG project, as well as our continued drilling and remedial efforts to stem production declines from our legacy assets.

Commodity prices across the whole spectrum of oil related products were exceptionally strong this quarter. Geopolitics has taken a front and center position throughout 2018 and the imposition of tariffs stemming from the U.S. China trade war, the upcoming November sanctions on Iran, and supply outages and disruptions all play a major role in price volatility and market uncertainty.

The geopolitical situation is clearly supportive of higher commodity prices but we also see strong signs of supply demand imbalances as well as the beginning of the upcoming winter season as supportive factors in the near term. Brent crude oil averaged \$75 a barrel in the third quarter

versus \$52 a barrel in the prior year or approximately 44% higher. And this trend is also consistent with Urals blend except that the usual discount spread narrowed from approximately \$2 a barrel to around \$1 a barrel.

Despite crude oil prices coming off to highs for the year in recent days there are clearly signs within a range bound that supports industry capital investments but does not negatively impact demand outlook. Commodity prices remain volatile for the foreseeable period as long as deteriorating geopolitical issues remain.

Global demand for LNG remain strong during the first 9 months of 2018 increasing by approximately 7.7% to roughly 239 million tons led primarily by the strong growth in Chinese natural gas consumption.

China imported roughly 38 million tons during the 9 month period representing a year-on-year increase of approximately 44% or almost reaching full year 2017 consumption during the first 9 months of the year. China's natural gas consumption is forecasted to reach between 275 billion cubic meters to 280 BCM in 2018, representing another year of robust growth. China will drive global gas growth for the foreseeable period and will be the favorite destination of LNG to supplement local production and the import of pipeline gas.

The global LNG market excluding China has also remained robust despite higher than expected LNG prices in both the Atlanta and Pacific basins. As I mentioned on our last conference call we saw new important entrants in the market as well as a continued build out of regasification terminals in key markets. These developments remain important but we need to be cognizant of some of the new entrants like Bangladesh, might revise consumption forecasts as they did this past week, the market would still evolve.

For instance, India is on another pace for another stronger year of natural gas imports, albeit at a volume less than China but nonetheless important as both India and China are home to about 1/3 of the global population and represents a significant societal shift to cleaner burning fuels like natural gas to meet climate change initiatives and pollution issues.

We feel these market development as positive indicators of robust demand supporting our position that demand fundamentals for LNG will be revised significantly upward from relatively conservative forecasts. In fact, we are beginning to see revisions upward on future LNG demand growth as we have highlighted previously. And recently in anticipation of this increase in demand outlook, Shell announced one of the first significant FIDs or Final Investment Decisions with their LNG Canada project in British Columbia.

This FID announcement is part of the so-called second wave of LNG projects expected to meet forecast and supply shortages in the mid-2020s and represents a growing need to begin a new cycle for LNG investments. Ironically, this announcement has garnered much attention from an international press as the first significant new FID announcement. But preliminary estimates seem like continuation of high cost LNG options that have then plagued many of the recent big scale projects over the past 5 years. It's imperative that cost competitive LNG projects such as our Arctic LNG 2 get commissioned within the next 2 years to meet potential supply shortages in the early 2020s.

Our future energy platform underlying our prolific hydrocarbon resource base on the Yamal and Gydan peninsulas places us in a competitively strong position to deliver world scale and innovative LNG projects to the market in the upcoming decade. Our immense resource base comprising over 3.3 trillion cubic meters of conventional natural gas and growing combined with liquid outputs gives us a tremendous comparative advantage vis-a-vis our global competitors.

Moreover, our use of technology and innovation to reduce our capital costs and environmental footprint on permafrost is another example to unlock economic value and deliver low cost LNG solutions to consuming nations as part of our strategic theme of energy affordability and energy security and energy sustainability.

So let's begin by discussing an update on Arctic LNG 2. We have completed the field work but have given the engineers and contractors another 2 weeks to respond to some outstanding questions. As we have previously stated, our goal for Arctic LNG 2 with the use of the gravity base structures was to significantly reduce the liquefaction costs -- capital cost excuse me -- to insure that our future LNG platforms will provide low cost LNG to major importing nations.



We have achieved this aim with our new GBS LNG platform design. Accordingly we can confirm that the initial capital costs of \$20 billion to \$21 billion for the 19.8 million tons per annum of LNG produced from the proposed 3 GBS platforms of 6.6 million tons per annum as quoted by Mr. Nicholson is realistically achievable. Detailed design work will start this month and we plan to award the gas turbine package very soon after having signed a supply contract for the coil-wound heat exchangers.

We're striving initially to achieve a 40% to 60% Russian local content but our aim is to eventually raise this percentage to approximately 70%, if feasible.

We anticipate signing the GBS fabrication contract in the near future with a majority of Russian content due to favorable market and economic conditions. The GBS yard construction contracts have already been signed and construction started on time to meet our estimated GBS fabrication schedule commencing around July 2019. We aim to take an FID decision sometime in the second half of 2019.

Equally important, we repeatedly stated that potential partner interest is quite strong in our Arctic LNG 2 project and statements made by Mr. Nicholson, I and others support this assertion. Now that the feat is essentially completed we will reopen the data room to provide additional partners with additional information to facilitate their decision process.

The ongoing negotiations are very specific and at a very advanced stage. We have already named some of the participants that have expressed strong interest in our next project. So tonight we will not confirm speculative statements made recently in the press. This has been our longstanding policy on these matters so need to deviate from our norms. But I would like to make comment on the skepticism we read about regarding Arctic LNG 2's valuation. We see no valid reason why we would issue a formal press release and make public statements on a project's valuation without merit. Our entrance price for the project valuation has already been set. Therefore, there is no need to dispute the valuation underlying the sale of the initial 10% equity stake. In fact, what we believe to be more realistically the case is further upside to the resource base as we announced and confirm information we can achieve the cost savings relative to our Yamal LNG project. So in our view the valuation is quite conservative.

Let's consider a few important points. The preliminary C1+ C2 reserve base has been increased by approximately 405 billion cubic meters of natural gas and 40 million tons of gas condensate. This makes the Utrenneye field technically larger in reserves than the South-Tambeyskoye field, which is the field feeding natural gas into the Yamal LNG project. This makes the project more attractive to potential investors and is quite conservative now to a preliminary valuation target.

In addition, we have included the feed process and are now taking further steps to de-risk the project as well as to optimize the logistical model. We will provide additional updates as is customary within our communication process to the investment community in due course.

We are very optimistic about our future LNG platform given forecasted LNG and natural gas demand scenarios. The transition from coal to natural gas in the primary energy mix to support climate change and sustainable development principles, as well as evolving LNG trade and expected increase in market liquidity. We would like to reiterate this point because many commentators and analysts talk about natural gas as a transition fuel. In our opinion this characterization is blatantly wrong. Natural gas is a primary fuel and not one in transition. Our strategic communication goal and that of the oil and gas industry should be able to talk about coal as a transition fuel since we believe we are transitioning from coal to natural gas. Not a bridge fuel, not a transition fuel. Natural gas both pipeline and LNG will play a major role in the future energy mix and will be a key contributor to meet climate change and decarbonization goals.

Arctic LNG 2 and our LNG projects beyond represent our belief that we at NOVATEK can substantially contribute in a meaningful way to the next wave of LNG projects to deliver cost competitive LNG to the market including facilitating the global LNG trade by constructing our transshipment facilities in Murmansk for the Western route and Kamchatka for the Eastern route establishing a Russian Far East FOB pricing hub to support regional trade and optimizing the use of the Northern Sea Route for full year navigation.

Moreover, our recent announcement with Fluxys to construct a 300,000 ton LNG transshipment terminal in German port city of Rostock, one of the first such LNG terminals in Germany, is another indication that the market is seeking integrated solutions to facilitate demand growth in natural gas to offset declining coal usage to meet decarbonization targets as well as transitioning marine bunkering fuel to LNG as part of the sulfur emission reductive mandated by the IMO by 2020 and the use of natural gas in truck transport.



Our goal is to capture a niche market for natural gas using expected LNG output from our Cryogas-Vysotsk LNG plant in the Leningrad region. This will allow us to consider LNG fueling into heavy trucks and bunkering. Projects like the Rostock LNG terminal is of strategic importance to us and we will find support in the European Union.

We have been investing in the construction of the first train at this liquid action plan comprising 660,000 tons which we expect to launch by year end. We completed the hydraulic testing of the 43,000 cubic meter LNG tank, the 42-kilometer gas pipeline link, buildings and the LNG loading berths, ongoing construction activities related to pipeline racks and electricity grid. And we expect to pass the tactical commission reviews of the cargo berth and the pipeline link this month.

Although the current market for bunkering in the Baltic region is not big, not more than 100,000 tons the introduction of the new IMO sulfur emission requirement will slowly increase demand for cleaner options like LNG. Preliminary estimates indicate that the bunkering market in the Baltics can increase by almost 10 fold to around 1 million tons per annum by 2025 justifying our decision to enter this niche market. Moreover, a portion of the volumes from the first LNG train will be sold at regas terminals in Northwest Europe and Baltic countries. Part of the volume will be sold on trucks to the Baltic region and Scandinavia. We have already secured one major off taker for the LNG volumes from the first train.

We are also making progress at the LNG construction yard in Murmansk. Approximately 1,500 workers and more than 300 construction vehicles are presently onsite. More than 8 million cubic meters of soil and rock have been excavated and work in this area is proceeding according to our civil work schedule. Activities relating to the construction of 2 loading berths and 2 dry docks are proceeding to plan. We recently commissioned construction of the basements for buildings for the workers' rotating village and for the concrete plant and a GBS construction plant.

Yamal LNG has unequivocally been a stellar performer for us and will represent a future benchmark for projects. As of today, we remain on target to deliver LNG train #3 in December, essentially delivering this world-class LNG project more than 1 year ahead of schedule and on budget. A huge accomplishment for NOVATEK and our partners and a project that has catapulted our LNG projects from speculative to realistic.

As of September 30th, the overall construction progress at Yamal LNG was approximately 96% completed, up from 94% at the end of the second quarter. More specifically, we successfully launched LNG train #2 during the reporting period in August of 2018. And achieved record ramp up of the facility in just 8 days as well as achieving a record ramp up for the combined first and second LNG trains. This represents an unprecedented achievement for the LNG industry.

Progress on LNG train #3 is 91.5%, up from 82.7% in the second quarter, which gives us confidence that the LNG train will be delivered as scheduled. The commissioning process for train #3 has already begun, the firing of the gas turbines is completed.

We drilled and completed 126 production wells, exceeding the well count of 124 production wells needed to launch all 3 LNG trains and this represents about 60% of the total numbers of wells proposed in the original development plan. Construction of the gas [grid] lines for the third LNG train is currently ongoing.

During the first 9 months of 2018 we ran and processed 2,830 linear kilometers of 2D seismic and 3,106 clear kilometers of 3D seismic to support our ongoing exploration activities. Our geological and geophysical work has yielded positive results supporting our exploratory drilling efforts. We had a number of positive results such as the drilling and testing of well #294 at the Utrenneye field confirming 2 new commercially viable hydrocarbon deposits at the mid Jurassic deposits. These discoveries allowed us to increase our reserves by 405 billion cubic meters and as of the 30th of September upon state commission approval our C1+ C2 reserves amounted to approximately 2 trillion cubic meters. We have now successfully tested the lower and mid Jurassic horizons at this particular field.

We also completed the first exploratory drilling of well #1 at the North-Russkoye license area owned by Arctic LNG 3 at a vertical depth of 2,800 meters in the shallow waters of the Ob Bay. As a result we have discovered a new field, the North-Obskiy field, which we estimate contains more than 320 billion cubic meters of natural gas, as well as an undefined amount of gas condensate. Although we only tested a portion of the hydrocarbon bearing structure due to the rig's limited ability to reach the lower Jurassic layers.

The reserve data will be submitted to the Russian state reserve commission for approval in November.

This represents a major new gas discovery for us, and indicates that we should expect the total Yamal and Gydan peninsulas reserve base to be revised upwards from the initial estimates of 3.3 trillion cubic meters. We were originally planning to drill the second well in 2020, but are now considering drilling the second well in 2019 as we begin to develop and prepare our resource base for the next LNG project, beyond Artic LNG 2.

We reached a Jurassic horizon on well #147 at the West Yurkharovskoye field and a positive decision was made to go forward with a full 15 well drilling program targeting the Jurassic layers. Accordingly 2 additional drilling rigs will be mobilized to the area this winter season. We also completed well #1 at the Nyakhartinskiy license area and have begun the testing phase at this particular well. We expect results to be finalized by year end.

Finally, we completed the Jurassic layer drilling at the South-Tambeyskoye field with a total well bore run of 5,040 meters at a vertical depth at 3,780 meters. We will utilize the 5 stage fracking program, using approximately 2,000 tons of proppant with testing results expected by year end.

During the third quarter we completed the drilling of 26 production wells versus 17 production wells in the prior comparable period. We drilled 5 wells each at the South-Tambeyskoye, Yurkharovskoye and East-Tazovskoye fields, 4 wells at the North-Russkoye cluster, as well as completed 7 additional production wells at our other producing fields. We continue to invest capital in drilling production wells to achieve our development plans as well as meet our production targets to support our marketing efforts.

To offset some of the decline in crude oil production at the Yarudeyskoye field largely attributable to a higher gas factor in the crude stream we have decided to implement a new 15 well drilling program, as well as other remedial measures, to stabilize crude oil production or decelerate some of the declines. The new plan calls for the drilling of 1 well in 2018, 11 wells in 2019, and 1 well in 2020.

We will also transfer 13 production wells into water injection wells to stimulate crude oil production. Our crude oil production will be supplemented by the eventual launch of the Yaro-Yakhinskoye field at our Arctic gas joint venture in December 2018. With a 9 month period we drilled 63 production wells at this new field representing a 267% increase in the number of wells completed over the 2017 prior period.

This new field is estimated to produce approximately 1 million tons per annum of crude oil at plateau levels reached by the end of 2019. Our [other] joint venture had a decline in production output this quarter, which is explained by one, a change in ownership from 53.3% to 50% with the completion of the parity restructuring between us and Gazprom Neft and two, the scheduling of maintenance work in the third quarter 2018 versus maintenance work performed in the second quarter of 2017.

Otherwise average daily gas production is reasonably flat year-on-year but we plan to commence production at the Achimov layers at Samarskiy license area in 2019, which will drive additional production growth at this joint venture. Ongoing work activities at our North-Russkoye cluster is proceeding as planned but there are no new updates to provide tonight except that we are still on target to officially commission the initial stage of the field in the latter part of 2019.

We signed a licensed agreement for the Ust-Luga hydrocracker upgrade. We also completed the tender list of participants and engineering surveys are presently in progress. Main construction activities will commence in 2019 and be completed by mid-2020 for formal launch of this upgrade. There are no revisions to our -- as prior estimated capital costs of RUB 19 billion and we expect the payback period of less than 3 years based on preliminary margin enhancements from moving from heavy oil to lighter products in the output mix.

We discussed briefly on our last conference call some of the market confusion about the shipping situation here in Russia. Quite frankly, we believe these new stories are overblown and present a more negative slant than reality.

The Russian government is very supportive of our LNG development activities and as we mentioned at our Yamal LNG project concerning shipping is being fully realized within the existing legal framework of Russia. We also mentioned that any new law regarding domestic flag vessels will not negatively impact our Arctic LNG 2 project from the vantage point of future LNG vessels and logistics.

There was also concerns indicating on the construction of future LNG tankers. These concerns are totally unfounded. [Vezda] is developing the respective ship building capabilities and have partnered with firms possession of the appropriate technical skills including construction LNG tankers to meet our technical specifications in time schedule.



Obviously, we take this matter seriously and we will not jeopardize the timing of our future LNG projects, but this point had been voiced by our shipping team in various meetings with the government in representation of the shipping concerns. Optimizing our LNG logistical model will ultimately unlock enormous economic value for NOVATEK and our shareholders so this area is being closely studied by our specialists in shipping and our commercial teams.

We announced that we will construct 2 transshipment facilities in Murmansk and Kamchatka as well as look at ship to ship transfers in Norway, to minimize the use of Arc7 ice-class tankers in non-ice waters and maximize their use to shuttle between the terminals and the LNG facilities. We also announced the joint venture with Rosatom to construct LNG powered icebreakers that we will use in the Ob Bay area allowing the larger state owned nuclear ice breakers to transverse the Northern Sea Route. This facilitates the efficient use of the nuclear icebreakers where they are most needed, and opens the Arctic sea route for a longer time period.

The joint venture with Rosatom is not the same as the new shipping society we established Maritime Arctic Transport or MART. MART has a completely different objective, with its aim to optimize our shipping logistics, better manage diverse shipping and port operations and reduce overall transport costs. Collectively these entities' goals are consistent with our desires to reduce overall shipping costs and minimize the number of Arc7 ice-class tankers needed for our future LNG projects.

As of today we have 7 Arc7 ice-class tankers in operations and we can say without reservation that these vessels have exceeded all of the design and operational expectations. During the third quarter, 3 vessels made their inaugural transit through the Northern Sea Route to the Asian Pacific markets in record time, confirming once again that this navigational route reduces time and nautical distance by about 50%. We will receive an additional 2 tankers the Georgiy Brusilov in November and the Boris Davydov in December bringing our total fleet to 9 vessels by year end. This number is sufficient to meet the needs of our current LNG output.

In early January -- in early 2019 -- excuse me -- most likely in January, we will receive another tanker with the remaining 5, Arc7 tankers arriving throughout 2019. We will supplement this tanker fleet with lesser class ice breakers, such as Arc4 when and where needed, to ensure uninterrupted LNG shipments to international markets.

During the third quarter we spent approximately RUB 24.3 billion on total capital costs. Approximate 39% or RUB 9.4 billion of our capital program was spent on the Arctic LNG 2 project and infrastructure for future LNG projects by approximately RUB 6.4 billion or about 26% was spent on the North-Russkoye and North-Obsskiy license areas and the East-Tarkosalinskoye oil program.

The remaining 35% was spent on a myriad of other capital related activities the largest of these costs comprising development activities at the Yarusheyskoye field and Gydansky license area to hydrocracker project at Ust-Luga and our new office complex here in Moscow.

Our capital program represents a significant year-on-year increase by roughly RUB 17.4 billion or by 250% and higher quarter-on-quarter by RUB 2 billion or by 10.5%. The increase in our quarter-on-quarter capital expenses reflects the drilling of well #1 at the North-Russkoye license area and other work related activities at this site, continued progress at the LNG construction yard in Murmansk and new office complexes in Moscow and (inaudible) and the Ust-Luga hydro-cracker update.

The financial and operational results were quite strong year-on-year and quarter-on-quarter largely due to commencement of LNG sales from trains #1 and #2 at Yamal LNG but equally important by a very favorable macro environment of high commodity prices across the whole spectrum of energy related products despite a quarterly drop in liquid sales volumes are roughly 339,000 tons or 7.9%.

Our total oil and gas revenues in the third quarter of 2018 exceeded both the year-on-year and quarter-on-quarter comparators. We increased our oil and gas revenues year-on-year by 68% and quarter-on-quarter by 12% through a combination of increased LNG sales volumes, stronger commodity prices for liquids, as well as enhanced margins for natural gas from the LNG sales.

Natural gas represented an increase of approximately RUB 37 billion of the change in our oil and gas revenues. Whereas, liquids accounted for approximately RUB 51 billion of the change between reporting periods. We sold 15.6 billion cubic meters of natural gas in the reporting period

versus 13.9 bcm year-on-year and 15.2 bcm quarter-on-quarter representing an increase of 12.2% year-on-year and 2.6% quarter-on-quarter, respectively.

Our combined average natural gas price of RUB 5,869 per MCM was up year-on-year by 50% and quarter-on-quarter by 33% reflecting the higher mix of LNG sales on our gas portfolio. Natural gas net backs domestic and international were also very strong in the reporting period reflecting the blending of domestic and international gas sales during the quarter.

Our natural gas net backs increased by 85% year-on-year and 52% quarter-on-quarter. The change between the second and third quarters 2018 was even starker as we saw higher value LNG in the natural gas make up with the ramp up of LNG train #2. These higher margin sales increased the percent of natural gas sold in the total revenue mix from 34% in the second quarter to 42% in the third quarter, essentially meaning that liquids contribution to total oil and gas revenues as a percentage declined.

We mentioned on the second quarter conference call that comparability of information is somewhat distorted with the launches of trains #1 and #2 whereby our 9 months in 2017 results were without LNG sales. This distortion also occurs during the ramp up phase of each train as volume off takes are based on our equity ownership sold primarily in the swap market.

The LNG sales volumes quarter-on-quarter increased by 1.2 bcm or by about 179% and represented almost 12% of our share of natural gas volumes sold versus only 4% in the second quarter. Comparatively, the average price per MCM in Russia rubles for LNG sales increased relative to our Russian domestic gas price by 4 fold in the current reporting period demonstrating the positive impact the Yamal LNG project has on our financial results.

Another way to consider this point is that LNG sales abroad represented 39% of our natural gas revenues on 12% sales volumes as mentioned. It is important to stress that we take advantage of the additional equity volumes during ramp up but nonetheless the strength in prices per MCM or MMBtu is indicative of future earnings potentials from our LNG platform. We will have a mix of spot and contract volumes and this mix will continue to respective ramp up of LNG train #3 as we will market a combination of equity interests and direct contractual sales via NOVATEK Gas & Power as an off taker.

The net impact will positively support revenues and especially since we can market the spot volumes during the upcoming peak demand season. During current reporting period we increased our injections of natural gas in storage by approximately 950 million cubic meters versus 815 million cubic meters in the prior year. We have approximately 2.4 billion cubic meters in underground storage or LNG in tankers in transit at the end of the reporting period.

For the first 9 months of 2018 Yamal LNG offloaded 67 LNG cargos from the plant representing approximately 5 million tons of LNG, very strong progress on a quick ramp ups. This week, Yamal LNG achieved 6 million tons of LNG produced since the plant's inception and the new Arc7 ice class tanker the Vladimir Vize received its first LNG cargo.

NOVATEK on the other hand sold 32 cargos of LNG during the first 9 months of the year including 17 cargos in the third quarter representing cumulative LNG sale volumes of approximately of 2.28 million tons. In the third quarter 2018, we dispatched our first LNG cargo to the Brazilian market with the LNG produced by the Yamal LNG project. The cargo was delivered to the Bahia regasification terminal owned by Petrobras. We have now delivered LNG to 5 continents since inception of the Yamal LNG, demonstrating the commercial viability to deliver cost competitive LNG to key consuming markets of the world.

We sold approximately 1.8 billion cubic meters of natural gas by the end of the quarter as compared to 653 million cubic meters in the second quarter. We anticipate the number of spot cargos sold will increase in the upcoming fourth quarter relative to long-term contracts, which will be further supported by the early ramp up volumes from the launch of LNG train #3. This same combination pattern of early ramp up or spot sales and long-term contractual volumes will persist until all 3 LNG trains are operating at full capacity and we revert primarily to long-term contractual sales.

We sold 3.8 million tons of liquids representing a 5.8% increase over the prior year but a 7.9% decrease relative to the second quarter 2018. We exported 57% of our total liquid volumes, which was higher year-on-year by 3% the lower quarter-in-quarter by the equivalent percentage. The



average price received in dollar terms was significantly higher across our liquid product range except for small volumes or domestic product sales. Because of the significant increase in international commodity reference prices, which translated into higher ruble denominated revenues that was partially offset by higher export duties. Nonetheless, a very strong pricing market for oil and gas producers.

Our third quarter liquid sales are also positively impacted by realizing revenues from prior inventory balances classified as goods in transit. We had 245,000 tons of liquid in transit at quarter end and these volumes will be realized as revenues in the subsequent reporting period. This compares to 314,000 tons at the end of the third quarter 2017 and 196,000 tons at the end of the second quarter reporting period.

As at the 30 September 2018 we had 850,000 tons of liquids in various stages of inventory and 2.4 billion cubic meters of natural gas in underground storage, which we realized during this year or used to ensure adequate inventories available for peak demand. Our financial and operational results will always be impacted year-on-year and quarter-on-quarter by relative inventory movements and the ultimate time in event to realize these balances as revenues.

Our operating expenses increased by 66% year-on-year and roughly 16% quarter-on-quarter in the current reporting period as compared to prior periods, which reflects the growing and evolving nature of our business activities. Our purchases of hydrocarbons have increased substantially over the past several quarters, with the successful launch of Yamal LNG and our ability to purchase LNG at our equity position during the ramp up phase and before the start of contractual volumes.

In addition, our liquid purchases were also impacted by the higher commodity prices paid to our joint ventures. Purchases increased by RUB 59 billion and RUB 31 billion year-on-year and quarter-on-quarter, respectively, reflecting the higher unit causes for both liquids and natural gas.

Hydrocarbon purchases as a percentage of our total operating expenses has essentially changed the dynamics of our cost structure both in absolute numbers and by percentages to total revenues. Purchases now represent more than double the [Nexus] Bench category transportation which historically has been our highest expense since we began publishing our financial statements. This reflects our evolving business model as joint ventures play an increasingly important role in our operations and our financial results.

Besides purchases, the most significant cost components on our operating expenses are both transportation and taxes other than income as traditionally has been the case. There were no unusual fluctuations in our operating expenses this quarter. However, there were specific increases in G&A expenses related primarily to payment of bonuses to key employees and their associated social and insurance contributions an increase in administrative personnel by roughly 9% and our normal annual salary indexation for all employees.

Our cost trends have been reasonably consistent over the past several years as our operating expenses supported our business operations as well as fluctuate periodically due to increase in the personnel, accruals of bonus payments, and a corresponding adjustments to salary indexations and social payments.

Our balance sheet and liquidity position also remains extremely strong. We have focused on strengthening our financial position and this has clearly been reflected over many quarters as we generate robust operating cash flows to fund our business operations, internally finance our capital program and service all of our liabilities and debt obligations that become due. In the current reporting period we generated free cash flows of RUB 26 billion, which was lower than both comparative periods but reflects a significantly higher capital spent in the current reporting period as we invest in our future LNG platform, (inaudible) the next large domestic gas and gas condensate field, as well as ongoing development and exploration projects.

Our total free cash flows for the 9 months ended June 30th -- excuse me -- it was ended September 30th was significantly more than RUB 104 billion or relative comparable to the prior period despite significantly higher capital costs. We achieved an EBITDA of RUB 118 billion, which is about double the prior year and 17% higher relative to the second quarter 2018.

Our operating cash flows exceeded our cash used to finance capital expenditures by 2x despite the fact that we significantly increased our capital spend on our capital program year-on-year by 337%. This also implies quarter-on-quarter as we increased our capital spend by 12%.

We fully funded our capital programs through internally generated cash flows. We approved all of our credit metrics during the reporting period and again demonstrated a solid balance sheet to easily support our international and domestic credit ratings.

Our net debt to normalized EBITDA stood at 0.31 versus 0.45 at year-end.

In conclusion, our 9 months financial and operational results were again stellar and demonstrate our ability to generate substantial cash flows from our transition and transforming business models from a purely domestic gas producer to a major LNG exporter. The ramp up of Yamal LNG had a positive impact on our per unit realizations for natural gas as well as positively contributive to our revenues from the LNG volumes sold to the international markets.

We have stated many times that Yamal LNG and broadly speaking our future LNG platform will substantially change and dramatically transform our business. This was expected and our financial results already confirm these benefits. We believe these positive benefits will continue to accrue to our financial and operational results as we further build out our LNG platform.

2018 represents a pivotal and important step for NOVATEK as the international oil and gas community recognizes the successes we achieved with the Yamal LNG project. We are no longer considered an outlier by our peers but instead an integral player in the future LNG market with an asset portfolio second to none in terms of hydrocarbon resources and market position.

We have delivered the first 2 LNG trains according to schedule and train #3 is preparing for its formal launch in December, a full year ahead of its planned launch day. It's worth again noting that this accomplishment launching on time and on budget has been unprecedented in an environment where delays and cost overruns have become accepted business practices and a new norm.

We continue to see this negative trend as a few U.S. projects have recently announced further delays in project start dates. We reject that notion and kept focused on delivering what we said we've delivered to our valued shareholders and in a process create sustainable shareholder value. This has been a cornerstone of our success over the years and we are proud of these achievements.

Our next LNG project Arctic LNG 2 has garnered much press releases recently with comments made by various parties interested in entering this large scale LNG project. We understand their interest in our LNG platform. It will be a global LNG game changer. We will significantly reduce our operational footprint with our new LNG platform based on gravity structures that will be 4x more compact than Yamal LNG. We'll also reduce our liquefaction cost per ton of LNG produced and reach our stated target as initially confirmed by the FEED study.

Innovation and technology will unlock our massive low cost long lived conventional resource base on the Yamal and Gydan peninsulas with this project and those earmarked after Arctic LNG 2.

There is no disputing our endowment of hydrocarbon resources. Everybody recognizes that our geographical zone of operations is endowed with an enormous resource potential that is cost effective to exploit and provides the necessary natural gas feedstock to build scalable LNG projects to meet growing LNG demand. Moreover, we have demonstrated without doubt the operational efficiencies gained from the colder ambient temperatures of the Arctic area, which many people considered a disadvantage at the beginning. Again, we prove the skeptics wrong.

The transition from coal to natural gas has begun. Natural gas is not a bridge fuel but rather a significant component of the current and future energy mix. The consumption of natural gas and power generation, industrial and in residential use will grow as countries [start] climate change initiatives and seek carbon friendly means to fuel economic expansion as well as economic prosperity to many people in the world today without affordable access to electricity.

The global trend toward electrification will proceed unabated and natural gas from renewables will be the primary source of energy to achieve this and in the upcoming decades. We understand the change in energy landscape ahead of us and our responsibilities to deliver affordable, secure and sustainable energy to a growing number of important consumer nations. The ability to deliver low cost LNG under flexible commercial trading arrangements will define the winners and losers in this evolving landscape. Competition among producers will not be defined geographically but



rather by those companies, delivering low cost natural gas in a race to displace coal in the energy mix. Quite simply it comes down to a fuel on fuel competition with coal and we believe natural gas will emerge as the winner.

Equally important we understand our responsibilities and stewardship in sustaining the ecological region of the Arctic territories where our base of operation is located and we recently released our 11th Sustainable Development pod which can be downloaded from our website that addresses this important topic.

NOVATEK supports these climate change initiatives and recently we signed the UN Pact on Human Rights. Sustainable development is embedded in our operational procedures and fundamental to our corporate strategy. We have lofty goals in our corporate strategy to 2030 by developing our hydrocarbon resource endowment into a major LNG producing zone and serving multiple geographical markets as we have already demonstrated by reaching 5 continents with shipments from our Yamal LNG project.

But this is not our complete story. Besides LNG we will actively develop our resource base within reach of a unified gas supply system to deliver uninterrupted natural gas to the Russian domestic market as well as consider further options to stimulate additional demand for natural gas on the domestic market.

We are on target to deliver the initial launch of the North-Russkoye field in 2019 as well as incremental production on various fields from developing the lower producing horizons of the Achimov and Jurassic formations.

We anticipate fully loading our processing facilities at Purovsky and Ust-Luga in 2019 and beyond as our liquids business remains a significant contributor to our profitability and cash flows.

We see the hydro-cracker upgrade project at the Ust-Luga plant as further proof that we will have enough liquids to fully load our facilities and transition the output slate to higher margins lighter fractionations. Despite ongoing discussions regarding changes or amendments to upstream and refining tax legislation we see no negative effect to our business and financial results.

Ladies and gentlemen, dear shareholders we would like to thank everyone for attending tonight's conference call and your continued support of NOVATEK. It has been an extremely volatile market and frustrating one to comprehend especially the recent volatility in the equities markets. Our management attention is focused on delivering sustainable shareholder value. We avoid the distracting external noise. In this regard, we are well positioned to begin our next major LNG project Arctic LNG 2. The market undoubtedly welcomes the diversity of supplies delivered cost competitively. We will keep everyone informed as usual about our going developments.

We would like to end tonight's call on a positive note. We are very proud of our recent announcements to build a new residential school for 800 schoolchildren in a beautiful settlement located in the Gydan Peninsula as well as our ability to launch the health territory charity project to assist children with medical care and targeted age in the Yamal-Nenets Autonomous Region.

This area is the principal home of our major oil and gas operations. Social commitments are often overlooked in the grander scheme of our development activities and lofty LNG ambition but it is crucial that we give back to society, aid those people less fortunate to us and develop the future generation of Russia.

We would like to thank everyone involved who made these possible. We are now ready to open tonight's call to our question and answer session. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Alex Comer of JPMorgan.



Alex Robert John Comer - *JP Morgan Chase & Co, Research Division - Research Analyst*

Just one question. You were very vociferous in calling on the valuation that's been ascribed to Arctic LNG 2. I mean just simplistically the 10% sale to Total for RUB 25.5 billion overall valuation. Is there any reason for me not to think that that sounds like directly to a RUB 2.5 billion cash payment from Total to you guys at some point in the 2019 year? Or is there some other wrinkles in the way that, that's going to play out?

Mark Anthony Gyetvay - *PAO NOVATEK - Deputy Chairman of the Management Board & CFO*

Right now. The valuation, as you mentioned, is correct but we don't comment on the deal until it's done. So we expect to have that finalized by the end of this year and close the deal by the first quarter of 2019. And in 2019 we will disclose the results of our transaction.

Operator

(Operator Instructions) We will now take our next question from Ron Smith of Citi Bank.

Ronald Paul Smith - *Citigroup Inc, Research Division - Director and Senior Russian Oil and Gas Analyst*

Couple of questions regarding Yamal LNG. Could you give me a confirmation on the launch schedule for train 3? The last I had heard it was going to be either December or January, I'm curious if you have any finer time lines on that? And second, I remember, back I guess in February, you did a capacity test on train 1, and it came in -- I don't remember the number now, 8% or 10% above nameplate. And you'd said at that time you'd need to test it in the summer to get an idea of the full -- the year round capacity relative to nameplate. Now that we're out of summer can you give us any more information on that?

Mark Anthony Gyetvay - *PAO NOVATEK - Deputy Chairman of the Management Board & CFO*

Thank you, Ron. I said we don't have a date scheduled yet but I said it'd be December this year on the launch of train #3. And as we get closer we'll be able to announce that. But right now or just leave it at in December. And your second question on capacity, we did say correctly that we would monitor it over the course of a whole year, and I would rather wait and let it go the full year of operational history before we comment on that. It's -- I think it's incorrect to make a statement on quarterly -- because we're also, remember of ramping up train #2 at the same period of time. All I would say at this every juncture is that we're operating above the nameplate capacity in both of those trains but to give you an exact percentage let's wait till we get it through the whole year and let's see how it operates. I'll probably do that some time after maybe after the first quarter's conference call.

Operator

We can now take our next question from Igor Kuzmin of Morgan Stanley.

Igor Kuzmin - *Morgan Stanley, Research Division - Equity Analyst*

I just wanted to ask 2 questions here, please. One is, is it possible to comment on the percentage of total production from Yamal train 1 and train 2 that NOVATEK has been off taking in Q3 and how that might be changing in Q4? Off taking meaning sort of NOVATEK purchasing from Yamal LNG and then marketing it elsewhere in the rest of the world. And the second question, in terms of the Arctic LNG 2, are there any sort of details that you potentially can disclose around how the contracts potential might be structured and what sort of pricing formulas are in discussions if possible?



Mark Anthony Gyetvay - PAO NOVATEK - Deputy Chairman of the Management Board & CFO

Thank you, Igor. On the first question, we basically say that we -- in the third quarter -- first of all I said we had -- we took 32 cargos for the 9 months and I said including 17 cargos in the third quarter. So the total volumes off take in terms of a million times was about 2.28. I don't have the breakdown specifically -- well I do -- in the third quarter -- excuse me I do have that -- in the third quarter we had about 1.2 million tons of LNG.

Igor Kuzmin - Morgan Stanley, Research Division - Equity Analyst

Okay. So that was the number in the third quarter.

Mark Anthony Gyetvay - PAO NOVATEK - Deputy Chairman of the Management Board & CFO

To estimate what is going to be in the fourth quarter -- post the third quarter -- it would depend on the startup data on train #3 because that's obviously have an impact on the volume sold. So I would reserve not answering that part of the question. But 32 cargos for the 9 months, 17 cargos in the third quarter, 2.28 million tons for the 32, and 1.2 million tons for the 17 cargos approximately. Right. On your second question, I mean we're in discussion with people on off take agreements right now and -- but again it's premature to provide you any guidance at this particular point in time because we have stated previously that it will be a combination probably by the time this project launches in 2022 there will be a combination of spot and long-term contractual sales. I think what we said, we don't need to have many long-term contracts to support the financing because the structure of the deal will be completely different more equity contributions rather than debt contributions. But to give you an indication right now, I would -- the best I can say it's going to be some kind of hybrid pricing model as the market evolves more towards that structure. But to give you specifics it's too early to give any specifics.

Igor Kuzmin - Morgan Stanley, Research Division - Equity Analyst

I was just more kind of looking for indication of what it is now in terms of how -- exactly how you said, just trying to understand why the market is moving if for example, if it's a slope and sort of what sort of slope we are talking about? But if it's too early from your side to comment on it then we will wait.

Mark Anthony Gyetvay - PAO NOVATEK - Deputy Chairman of the Management Board & CFO

Any way -- first of all like, I think, we've said many, many times before, we don't disclose the commercial terms specifically on contracts. I think what you can see what I tried to point out today in today's conference call is that if you look on the average price you can see a substantial growth in the average price recorded for natural gas. And I think that's reflective with the Russian prices and that's reflective of the LNG sales. And I try to highlight just assertively by saying 12% of the volume represented about 36% of the revenue. So I think you can see the impact that the LNG sales has to our financial results as well as its positive impact to the per unit, but we're not going to disclose individually (inaudible) with on a contract.

Operator

We can now take our next question from Alexander Kornilov of Aton.

Alexander Kornilov - Aton LLC, Research Division - Senior Analyst of Energy Sector

Thanks for the opportunity to ask the questions. Actually I have a couple of questions. First of all as we now have around 10 months behind, almost. Can you assure that your targets i.e. production and CapEx what you said on '19 if possible? Maybe it's premature, sorry about that. And the second question is related to Arctic LNG again, during your presentation, Mark, you mentioned that the valuation of this project implied by the deal with Total looks rather conservative, if I got it right. Can you share with us, if possible, what kind of valuation you would attribute to that project and what kind of long-term oil price you are incorporating for that particularly valuation?



Mark Anthony Gyetvay - PAO NOVATEK - Deputy Chairman of the Management Board & CFO

Okay. On your first question on CapEx and production volumes. As historically been the case, we usually provide that guidance in -- during the first quarter conference call, or actually during the year-end conference call. Because what's happening now is that as the teams are going through the budgeting process right now, and once we get the budgeting process decided, looking at the capital program for 2019, that has to get approved by the management board. Once it gets approved by the management board then it has to get approved by the Board of Directors and that usually doesn't happen until some time in December. So we generally don't give these types of forecast out until after it gets approved by the Board of Directors. So I think -- sorry to say tonight for everybody who wants to know what our production forecasts for 2019 or CapEx, you just have to wait on that that particular point. In terms of Arctic LNG 2, I'm still kind of perplexed a little bit and surprised why there's so much focus on questioning this valuation. I mean, I don't see anybody questioning the Canadian LNG project at 31 billion. All I see is that Canada thinks it's the greatest thing. And everybody is supportive of this. But we give a valuation out after we were the only ones that were able to so far deliver a project on time and it was questioned. All right, I just don't see that, I just don't understand. I mean, when are we going to stop trying to question what we publish in the market. I mean we wouldn't put out a statement, a press release without it being discussed with our parties. And so I mean that should give you comfort right there that the valuation that's been ascribed to this particular project is what we say it is. And when we say, why we state it conservative right now, is we just added another 400 billion cubic meters of natural gas. We just added another 40 million tons of condensate to the project. We just completed the FEED study. I mean we've been working on value engineering this particular concept for more than a year now. We raised the initial output of the initial design from 6.1 million to 6.6 million tons per annum. So I mean Total made a decision early on to join this project. And we think, as it stands today, given all the positive attributes that we see accruing to the work we've done so far, we believe it's conservative, all phases going forward on projections, I mean, I don't think anybody can give you a realistic number. I mean we've seen what, \$65 as the reasonable average price long term. But we don't know if that is going to be [hold] over the course of the life of the project. The most important thing for us, right now, and what we've said before, we said at the strategy presentation, and we continue to repeat it throughout the year. Our goal is to be a low-cost provider of LNG to the market. The only way we are going to be a low-cost provider to the market is twofold. One, we can build a project that's low cost, meaning reduce the capital intensity of the project from what we did at Yamal, by moving everything from onshore development, using pilings et cetera on permafrost, to build these GBS systems. And we know it's going to cost us, relatively speaking, on the field development. Second is, how do we optimize the logistic transport on the Northern Sea Route? The more we can optimize that route by utilizing it on a longer time frame. And I think Mr. Nicholson has already commented before I think in his Vladivostok conference that we believe that we can reduce the transport cost by about 7% to 10%. So our goal right now is to deliver a project that is one of the lowest cost project in the world. And once we do that, we are absolutely certain that we can deliver volumes to the consuming nations. And you can see that already by the very interest that we have partners looking at this project. If it wasn't attractive value wise; if it wasn't attractive on somebody's oil price future index, whatever they are using, whatever discount rate they are using; they will not have been looking at this project. So right now, we still have strong interest, we think it's a great project, it can unlock the value in the Gydan and Yamal peninsulas. We think that we can eventually lower the capital cost per unit as we get more engineering experience when building out these units. And time will tell what the oil price will be in the future. Right now, it's very attractive. and as I mentioned earlier, we are selling spot volumes in a very attractive market. And we are going to be selling spot volumes in a very attractive market coming up in the winter season. So I think, let's give this credit and say that we have delivered our project on time, we have built a platform right now that I think people respect us in the industry for what we've achieved. And now it's our time to monetize this. And like I said to Igor on the previous question, you can see the results in the financial statements, it's without question. So let's wait a little bit. We don't have the crystal ball on the price tag. \$65 is a reasonable assumption to use. And we'll see how it pans out when we -- when we hit that time. So but \$65 is a reasonable target for us.

Alexander Kornilov - Aton LLC, Research Division - Senior Analyst of Energy Sector

Okay. Thank you, Mark, for such detailed explanation. I am not trying to challenge all your points, they all look reasonable. Let me just rephrase a little with a question. Let's say here for instance, how do you rank on someone else would buy just a share of that project? Would you expect them to pay a higher price compared to Total, or would it be a wrong assumption?



Mark Anthony Gyetvay - PAO NOVATEK - Deputy Chairman of the Management Board & CFO

Well, I tried to say, we set the floor, okay. So the floor has already been set. So people have -- we have -- they have their estimations, they have their chance to look at the [dial]. We hope that our partners will use the same logic for higher price and higher research. So hopefully, in our opinion right now the valuation that Total paid in is conservative. Okay. And if anybody would look at the project and looking at the fact that there's more resources, a lower cost that's been confirmed, means higher value. But I can't make that decision. The buyer is going to have to assess the value from their own perspective. And they're going to have to make that judgment call. What we did on this particular project -- what we did specifically, now excuse me, on the Yamal LNG project that's extremely crucial for us, is that we've been able to remove it from the Russian risk. So we're not looking at a project that's going to have a huge discount factor, as most people apply to the domestic gas business. So when you start doing it on a realistic basis and you take a realistic price forecast on the outlook of LNG prices, depending on whether they're going to bring it to the market, you'll see that this valuation that we have put for Yamal LNG is solid. And the valuation upgrade from Yamal to Arctic LNG 2 is recognition of what the market has evolved to. And so I don't -- I know you've not challenged me on the valuation question but we know right now that it's really going to be through the negotiations, whatever they feel is comfortable to pay for this project, and whether or not we believe it's fair value to us. We'll come to that conclusion. But right now, the floor has been established and we made that known to everybody who's interested in this particular project.

Operator

We can now take our next question from Thomas Adolph of Credit Suisse.

Thomas Yoichi Adolff - Crédit Suisse AG, Research Division - Head of European Oil & Gas Equity Research and Director

I'm afraid I have 3 questions, so bear with me. Firstly, just on the shipping fleet. You've mentioned that you will have more spot cargoes due to earlier start up and faster ramp up, was the third train likely a year ahead of the original schedule. So I wonder whether you've managed to get all the ships ready to facilitate these earlier volumes? And then secondly, in terms of the FID on Arctic LNG 2. I wonder whether you are open to do so without locking in long-term contracts like LNG Canada. Or will the timing of FID be dictated by the signing of long-term contracts for a decent portion of the overall volumes? And then I guess finally, the question I have is obviously, it is a popularity contest and you've done a great job on Yamal and a lot of credible LNG buyers want a piece of Arctic LNG, some claiming to want to have a bigger stake. So I wonder -- and of course, it will be driven by value but strategically whether it makes sense to have as many important LNG players joined a consortium as opposed to just a few? And then and perhaps will there be an early Christmas present or will it rather be a New Year's gift?

Mark Anthony Gyetvay - PAO NOVATEK - Deputy Chairman of the Management Board & CFO

Thomas, on the shipping, I kind of addressed that and said that as of today, we have 7 Arc7 class tankers in operation. And they seem to be operating efficiently, moving product back and forth to the marketplace. We have supplemented those vessels with the Arc4 class tankers. And we've been using about 4, I think right now about 4 of them to supplement. But they're of a lower class ice capabilities and we'd prefer to use them in areas where there is no ice. And then by transshipping back and forth, we've been able to offload into conventional tankers. So right now, we don't really see any issue. But then you bring up the question of the ramp up of the third train. As I mentioned, we have 2 more Arc7s coming, 1 in November and the other 1, I believe, is in December. And then, we have 1 coming in -- in probably beginning of the year, January, probably that (inaudible). So that gives us 10. And then over the course of the year, we'll get additional 5. Right? So right now, we fully anticipate that we have enough vessel fleet to handle all of our load. Other thing that we talked about and you may have read with interest is that we're going to do some transshipment ship to ship in Norway. That would also facilitate the use of a lower number of vessels to help us through this transition period. And Norway would be more or less a transition period until we -- or a temporary decision for transshipment and until we build the Murmansk facility, which should be around 2022. So I think right now, it's safe to say that I believe according to our commercial people, according to our shipment people, we're okay in shipping. And if there's any problem, obviously this will be raised up in the press like they usually does and we'll have to deal with it. But right now, we believe there's enough ships to transport our LNG to the marketplace. Your second question on FID with or without long-term contracts. Canada LNG made a decision to move forward with -- without securing long-term contracts, which is quite different than venture global like everybody else do on their flip side or securing long-term contracts. So it's going to be a combination. But I think the most important thing that



we stressed early on in some of our conversations. We talked about that the structure for Arctic LNG 2 would be more equity-based than debt-based, so with a lower debt-base. And right now, we're looking at probably a 70% equity 30% debt structure right now, preliminary on this particular project. We don't need to secure the same level of long-term contracts as we did in Yamal LNG, which was secured by 96% of under off-take long-term [off-takes]. But I think we got to also address this question in the time frame when this project will be moving forward because the evolution that we talk about, that the industry is looking at is that we expect to see more liquidity in the market by having more order borne LNG carriers around. We expect to see some of the trading portfolio players stepping in to facilitate some of the trading activity. So I'm not quite sure at this point as these projects are moving on the so-called second wave that we'll not see that evolution away from having a long-term contract secure -- the security decision to make an FID as well as to security decision on behalf of the bankers to finance a particular project. So -- but I think right now it's not imperative for the FID decision but obviously we're in the process of talking to off takers and when the contracts are signed, obviously, we'll make that announcement. But right now, I don't think it's imperative in the decision yet for the FID at this point. And your third question, and it's a little -- I mean it's hard to say. I mean because right now, what's speculative in the -- we have Total at 10%, and we hear speculation that Saudi Aramco wants a 30%, right. And we have speculation that maybe the Chinese or the Koreans or the Japanese are going to want to come in. I mean, what's important for us right now is looking at the end markets, how do we deliver these LNG volumes to the marketplace? And obviously, the countries that I mentioned that are interested in the particular projects are consuming nations. So what the mix is in terms of the size each partner takes. I think it's irrelevant to us. At the end of the day, whether we have 2 partners or 3 partners or 5 partners it doesn't matter as long as the valuation we obtain is the right valuation that we want for the particular project. Now obviously, let's look forward because what we're talking about here is scalable projects. So as we start with Arctic LNG 2, we finalize that. We're already focused on the projects beyond Arctic LNG 2. So I mean we have a platform ahead of us that will be viewed by the marketplace as a desirable place to invest in LNG, particularly, if we can continue demonstrating the operational efficiencies of the plant as we discussed a little earlier. And secondly, if we can open up the Northern Sea Route for full year passage, so it makes the time and nautical distance to the Asian markets much shorter. And then I think the other thing that we are now talking about there is also the swap arrangements. And so we should expect that we should see a lot of swap trading starting to emerge as these projects move forward with the second wave. So I think it -- today it's not really important the number of parties that are involved. I think it's really important the right parties get involved in our project. And I think the people that we are talking with today are the right parties that would be interested in not only Arctic LNG 2 project but more or less our LNG platform. And I think that's important for us.

Thomas Yoichi Adolff - *Crédit Suisse AG, Research Division - Head of European Oil & Gas Equity Research and Director*

And may I ask I last question just since you've mentioned Arctic LNG 3 de-risking the next project. Does NOVATEK have the organizational capacity to do 2 projects at the same time or should I consider Arctic LNG 3 to be sanctioned after Arctic LNG 2 is completed?

Mark Anthony Gyetvay - *PAO NOVATEK - Deputy Chairman of the Management Board & CFO*

Thomas, I don't know why you doubt that. I mean it's a -- I mean let me go back to the question of people doubting whether we are going to deliver any of these projects on time, and I think we've killed that skepticism. No, I mean of course we have the capability of doing it. It's not a capability the management of the project because we have been, we have been investing in our LNG business in terms of the right hire. And I think the question, the right question to answer on this particular -- to address your question would be whether or not the LNG construction yard in Murmansk can build out enough GBS structures to be able to have multiple projects doing consecutively, that's really the question right now. So that's a decision that obviously we are looking at and it's a decision that's very important for us, because it does have a, it does move us the way from sequential execution of projects to concurrent execution of projects. So it's not a management skill or management capabilities. I think we clearly demonstrated already that we can deliver a large scale project. So I think it's more like a technical question on the construction yard at this particular point. But also just to address that question a little further. You are bringing in -- because I talked about the North-Obnskiy field and I talked about Arctic LNG 3. We also have other fields that are in geographical proximity to the Utrenneye terminal which will be the point of shipments. So it may not be right away, it may not be the Arctic 3 that's the next project. So I apologize for the confusion in the number and structure but nonetheless we will determine based on the fields development activity that and also how successful we are with Arctic Cascade because that might also come into a decision about how we want to build on some of the other LNG projects as we are building out the GBS structures. We might decide that Arctic Cascade in a scale sufficient enough to do some of the satellite fields might be the next way to go out. So I think it's -- there is a lot of factors that come into that decision, it's not a straight forward factor, but I appreciate your question very much.



Operator

We can now take our next question from Henri Patricot of UBS.

Henri Jerome Dieudonne Marie Patricot - *UBS Investment Bank, Research Division - Associate Director and Equity Research Analyst*

Actually I wanted to follow-up on comments you just made about Arctic LNG 3. I was wondering the way results compared to your initial expectations and where your thinking is? Last year you had a number of 12 million tons for the capacity of the project. So are you thinking about (inaudible) the way result? And also secondly for Arctic LNG 2 and the upside potential you've mentioned with the new reserves you added, do you have enough to do a potential 2 additional trains at this stage or do you still need to do -- came up a bit more reserves?

Mark Anthony Gyetvay - *PAO NOVATEK - Deputy Chairman of the Management Board & CFO*

That's the important question right now, I mean that's why we've increased our exploration budget 5 fold to begin the process of developing and preparing our resource base in a stage that we can start making these decisions. That's the fundamental. Nobody is going to talk to anybody if you don't have your resource base proved up to a level that everybody feels is sufficient for us to rollout an LNG trend. So yes, you started up your question by asking about Arctic LNG 3 and the North-Obskiy field and did it surprise us? Well I think quite frankly I try to address that in a question that we were only able to drill down 2,800 meters, which barely got us into part of the horizon on the Valanginian layer. We were not even able to tap it into the deeper horizons due to limitation on the vessel. So to be able to come out already and say that we found a major hydrocarbon field on a initial test that we were not able to completely test all the horizons gives us enormous optimism that we've just now made a major new field discovery. And I try to say also that the 3.3 trillion cubic meters that we have earmarked on the Yamal and Gydan Peninsula is probably conservative and we probably see some significant upside to those particular numbers. And so again it comes to a question of not resources being constrained, it's how do we develop these resources and procure them so that we can put some projects out and start bringing people in. So to say North-Obskiy field was a tremendous, tremendous, tremendous upside for us. And it's -- we are very optimistic that this will be a major discovery across when we started drilling, that's why we are going to bring the well #2 up a year because we think this will be a field that needs to be prepared quicker. But largely I think the most important thing is that the exploration budget has been increased 5 fold to address that very question that you are looking for.

Operator

We will take our next question from Ildar Davletshin of Wood & Company.

Ildar Davletshin - *Wood & Company Financial Services, a.s., Research Division - Equity Analyst*

Thank you for taking my question, I've got 2 if I may. So 1, on Arctic LNG 2, just wanted to confirm the CapEx estimate or the cost of RUB 20 billion, RUB 21 billion for what looks like a 19.8 million ton that seems very conservative, does this include the upstream part as well, or is it just the infrastructure? And then the second on the Yamal LNG the current project, when do you expect is there a chance for earlier distribution of earnings at the project, given that it's -- the project is significantly ahead of original schedule, so what needs to be done and when we can learn about possibly an earlier distribution of profits among the shareholders?

Mark Anthony Gyetvay - *PAO NOVATEK - Deputy Chairman of the Management Board & CFO*

Thank you very much. Okay. On the first question the RUB 20 billion, RUB 21 billion is whole cast, that's both the liquefaction and the upstream part of it, so that includes the infrastructure. Okay. So I think that's pretty -- well in a range I think that we talked about in our strategy presentation. And I think we talked about the liquefaction plus the upstream side of the cost. So I think we are confirming that that number is reasonable so far. So I would just wait till we make that formal announcement on the FID decision, but that's that will be the liquefaction as well as the fuel development

infrastructure related cost. Now, your second one, your second question, we talked about on the second quarter we talked -- we spend a lot of time talking about, I think the first question on the second quarter conference call, about dividend payments. And because obviously this is of interest to everybody including ourselves. As relates to Yamal LNG I talked a little bit about the ongoing test that we had to do, the completion test and so we are now making the technical tests. So that's ongoing right now. I would say within the first quarter of 2019 maybe slightly after, maybe within the first 3 to 5 months, possibly 3 to 4 months, we're going to perform logistical and commercial tests, which will allow us historic cash distribution. So once we complete that level of tests, we can then start cash distribution between the project shareholders. And this will relate solely to interest and loan repayments. But -- so that's that point, but let's just look, I want to follow this on the dividend side too because I know it's also important. Because even without a dividend payment increase. Because I talked about that in (inaudible) to say that the payout would not happen until probably at best after we finished the structure of Arctic LNG 2 financing, partner selection et cetera, as well as the completion task. Let's be realistic that you're going to start seeing on an absolute basis the dividend payment will increase significantly because of the contributions that Yamal is already making to NOVADEK. And we try to stress that with the difference between the spot sales and the long-term contractual volumes and the early ramp up volumes which are attributable to spot. I mean this is an enormous benefit to our shareholders. And at this particular point in time that the additional cash coming into the particular project probably gives us a position we don't even have to drill down on a total depth position. So right now I think we're at a very good period of time to be able to like you eventually said strong cash generating project will be able to meet those completion and commercial logistical tests. Start paying back interest and loan repayments to the partner but also watch for a significant increase in the absolute number of dividend, because this is clearly representative of the profitability of the group today as well as the cash flow generation that we are receiving for these early ramp up lines et cetera. But right now I probably will ever say on the -- at that particular point.

Ildar Davletshin - *Wood & Company Financial Services, a.s., Research Division - Equity Analyst*

And maybe if I just could ask on the first question Arctic LNG 2. Given that you may probably need much less third party financing, I mean banking financing, is there -- have you considered selling more gas on the spot conditions, having more flexibility or you would fix more to long-term contracts maybe oil linked contracts like?

Mark Anthony Gyetvay - *PAO NOVATEK - Deputy Chairman of the Management Board & CFO*

That's a question that's been asked previously on the calls that -- I mean you're right, you're essentially right. I mean theoretically having a lower debt structure means that we don't have to go out and secure long-term contracts to support the financing structure on that, right. And there is the possibility there may be more spot. And this is what we talk about. Again this is what we are talking about the evolution in the market. I mean, you must be clear on this, because the market is looking at flexibility as a key term, flexibility in destination, flexibility in volumes, flexibility in term. And we are sitting in a point in time right now where, I think, I don't know if other sponsors realize this that this will eventually come, but at the same time. So this makes the confusion, at the same time we see Cheniere just execute a long 20-year contract with Chinese companies. We see Venture Global, again another LNG producer sign a long-term contract to support their project. So there is going to be a combination and although the evolution moves that we believe will move more towards spot, eventually. We are seeing contradictions to this as people are looking to secure volumes. So it's hard to predict right now if we'll say it's all spot, but the market is currently moving in that direction right now. But I would say at this point it's safe to say that to address your specific question and the way you -- it's probably safe to say that yes, we don't need to have as much long-term contracts to support that. But if somebody comes to us and wants to execute a 20-year contract, long-term contract for a set volume I mean of course we are going to listen to that. I mean that's the nature of our business. So I think right now when we start that process of announcing how the sales will look like that, we'll make the announcements on that. Or at least we'll update everybody on future conference calls. But your premise is right, but we are seeing some contradictions to the market right now, but I think ultimately the evolution that we talked about will be the new norm in the LNG trading. Because I think I alluded on the last call again too, I talked about, why did we have to have long-term contracts for LNG, but we don't have the same long-term contracts in the crude oil market. And the reason why you don't have that is that you have enough volumes trading that people aren't concerned about whether or not they are going to be able to lose a volume or not have to find a home for the cargo. So the more order bound -- the more order board, excuse me, volumes that we have in the marketplace right now, obviously we are going to move more to a spot trading. And also we'll start increasing the level of swap trading also. And that's how we see the market evolving. But we do have contradictions to some countries and some companies are still executing long-term contracts as we speak.



Operator

Thank you. As there are no further questions in the queue I will hand it back to our host Mark Gyetvay for any additional or closing remarks.

Mark Anthony Gyetvay - PAO NOVATEK - Deputy Chairman of the Management Board & CFO

All right. That was a long run, but anyway thank you very much to everybody. We appreciated your attendance today and your belief in our story. And I just hope that you can see the impact of the change in business model already in the financial results. And we believe that this will continue with the further launch of Yamal LNG's train #3 as well as positive news flow coming out of the eventual sale of Arctic LNG 2. So again thank you very much. We look forward to addressing you again on our final conference call in February. So thank you and have a good evening.

Operator

Ladies and gentlemen this concludes today's conference call. Thank you for your participation. You may now disconnect.

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