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PRESENTATION

Operator

Good day, and welcome to the NOVATEK Second Quarter 2019 Financial Results Conference Call. Today's call is being recorded.

At this time, I would like to turn the call over to Mark Gyetvay. Please go ahead.

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

Thank you. Ladies and gentlemen, shareholder and colleagues, good evening and welcome to our second quarter 2019 earnings conference call. We would like to thank everyone for taking their valuable time to join us this evening.

Before we begin with the specific conference call details, I would like to refer you to our disclaimer statement, as is our normal practice. During this conference call we may make refer 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 risk and uncertainties and reflect our views as of the date of this presentation.

We undertake no obligation to revise or publicly release the results of any revisions to these forward-looking statements in light of new information or future events. Please refer to our regulatory filings, including our annual review for the year ended the 31st of December 2018 as well as any of our earnings press releases and documents throughout the past year for more descriptions of the risks that may influence our results.

We had a very successful first half of 2019, thanks in large part to the contributions by Yamal LNG to our overall business results. Since inception we have garnered a tremendous amount of international recognition for the timely startup of this project. But more importantly Yamal LNG has contributed meaningly (sic) [meaningfully] to global supply of LNG in its initial 18 -- 19 months of operations and will remain the global benchmark for future projects to emulate.

LNG and our plans have essentially dominated our discussions with the investment community, as Yamal LNG has exceeded many expectations. Attention has clearly shifted towards our future LNG platform, but I would like to reiterate tonight that we remain fully committed and focused on sustaining our cash-generative domestic business by ensuring uninterrupted deliveries of natural gas to the Russian domestic market.

The first half of 2019 has been an exciting yet challenging period for the oil and gas industry and tonight we will address some of these points as they relate to our business plans and our perception of the market. Price volatility has increased significantly for natural gas as warmer seasonal weather curtailed consumption at a time of emerging new supplies of LNG arriving on the market. Essentially the so-called supply glut emerged later than originally forecasted. But this occurrence was not unexpected, as supply-and-demand equilibrium is hard to achieve in the best of circumstances and the launching of new LNG projects create a step-up in supplies with a general lag in demand. The market is currently oversupplied. We expect this scenario will persist until mid-2020 as the second wave of LNG projects bring new sources of supply to meet increasing natural gas demand.

Global LNG demand remained strong in the second quarter 2019, increasing 9% year-on-year to 88 million tons, led again by relatively robust LNG demand from China despite warmer seasonal weather. China imported roughly 14.1 million tons during the reporting period, increasing imports year-on-year by approximately 11%. Imports of natural gas via pipeline and LNG account for approximately 45% of China's consumption, so China remains an important and attractive market for LNG suppliers. Japan, Taiwan, Korea and China represent more than 55% of the global LNG demand according to a recent report by S&P Global Platts, demonstrating the importance of the Asia-Pacific region to LNG suppliers.

For the first half of 2019 LNG demand increased by 15% to 178 million tons, led by consumption growth in China, France and the U.K. This growth was somewhat offset by decreases in imports from Japan and South Korea. The weaker seasonal winter demand combined with new LNG supplies eroded margins in the Asian-Pacific region. This led to a shift of cargoes sent to the European markets. We expect that the current low LNG prices will likely persist throughout the second half of 2019 and may affect LNG prices throughout 2020 as well. With limited storage capacities and high levels of inventory levels as previously discussed on our first quarter conference call, the supply-and-demand situation remains unbalanced.

We should not assume that this present situation is all bed, although it puts pressure on profitability for some LNG producers. More importantly from our perspective, it should stimulate future demand growth, particularly in regions that are highly price sensitive. Our low-cost LNG, combined with our liquids outputs, differentiates our project. It confirms our belief that our low-cost, competitive-priced LNG platform will remain profitable in cyclical markets. Even in the current low LNG pricing environment, NOVATEK's LNG is competitive in Latin America, Europe and Asia.

In the first half of 2019 Yamal LNG produced slightly more than 9 million tons of LNG and 695,000 tons of unstable gas condensates. We dispatched 126 LNG shipments totaling 9.13 million tons of LNG and 27 shipments of stable gas condensate for more than 638,000 tons. The facility operated at roughly 110% of its nameplate capacity. We believe we can effectively run the plant at 8% to 10% above nameplate capacity in 2019.

In the second quarter of 2019 Yamal LNG dispatched 65 shipments of LNG, representing 4.7 million tons, as well as 13 shipments of stable gas condensate, totaling 319,000 tons. Our share of LNG production amounted to slightly more than 2.9 million tons. We transshipped most of the westbound LNG cargoes from Arc7 ice-class tankers to conventional LNG tankers in northern Norway. We performed the last transshipment in Norway on the 27th of June. We performed 123 ship-to-ship transfers from the start of operations in November 2018 to the final transfer in June 2019. If needed, we will perform future ship-to-ship transfers around the territory of Murmansk.

Presently there are 11 Arc7 ice-class tankers in operations and 1 Arc7 condensate tanker. 10 conventional tankers supplement our ice-class fleet. The 11th Arc7 ice-class LNG tanker, the Vladimir Voronin, will arrive in the port of Sabetta around mid-August. We expect all 15 Arc7 ice-class tankers to be in service by the end of 2019.

In 2019, as well as in 2018, our Arc7 ice-class tankers opened the navigation season eastbound on the Northern Sea Route. We plan to send at least 13 cargoes of LNG eastbound to the Asian markets during the 2019 summer navigation period under long-term contracts and between 5 to 10 spot cargoes. The Vladimir Rusanov was the first ice-class LNG tanker to navigate the Northern Sea Route this summer and has set another record passing through the Northern Sea Route in slightly more than 6 days.

The overall construction progress for the fourth LNG train at Yamal LNG was about 51% completed at the 30th of June as compared to 38% at the end of the first quarter. There are presently 1,500 workers on the construction site. We target the end of 2019 to complete construction, with the formal launch of the facility during the first quarter of 2020.

The main work activities center on the gas treatment and gas liquefaction units. We have installed 29 into 40 sets of equipment for the gas treatment facility, including main items such as a drying gas and treatment absorbers, absorber for gas purification from hydrocarbons, absorber for gas purification from mercury, air receiver, regeneration gas heater and a gas cooling compression unit, to name a few. As for the gas liquefaction unit, we installed the main compressor unit, the nitrogen compressor unit and the boil-off gas compressor unit. On the 3rd of July Cryogenmash delivered the main cryogenic heat exchanger to Sabetta and installed this crucial piece of equipment in the main liquefaction unit. Overall, we made good progress on construction activities during the second quarter.

As for Arctic LNG 2, we completed the consortium with the partners by announcing that Mitsui and JOGMEC will join the project with a purchase of a 10% participation interest. This represented a significant event for the project in the second quarter, but it also represented a significant milestone for us as a company as we've had numerous discussions with Japanese companies over the past 5 years about entering our LNG projects. Japan has over 50 years of experience importing LNG and is currently the largest consumer of LNG in the world. Subsequent to signing the ceremony at the G20 meeting in Osaka, we sent our first direct tanker of LNG to Japan. We welcome Mitsui and JOGMEC's entrance into Arctic LNG 2 and look forward to forging a long-term, mutually beneficial relationship.

We have now concluded our target of selling at least 40% of Arctic LNG 2 to a partner group consisting of Total, CNPC, CNOOC and a consortium of Mitsui JOGMEC. These transactions were based on the same terms and conditions at Total and will be reported in the financial results of the third quarter 2019, since the formal closing of the sale with the remaining 30% was finalized post the balance sheet date.

We also finalized the EPC negotiations during the second quarter with TechnipFMC, as well as concluded the EPC contracts which covers the work activities of the 3 LNG trains and associated topside modules. This represented another key step in the project's timeline prior to making a final investment decision. Moreover, the conclusion of the EPC contracts reconfirms our initial cost estimates for Arctic LNG 2.

We finalized the tender for the fabrication of LNG topside modules for LNG trains #1 and #2. As we've stated many times, our overall objective is to localize a large proportion of the fabrication at our construction yard in Murmansk, but this will be a gradual transition process. Initially we will fabricate the topside modules in select Asian yards, with a gradual transition to our Murmansk yard. We will fabricate all of the topside modules for train 1 at Chinese yards and this process will gradually phase out over trains 2 and #3. We will contract more than 80% of the planned procurement expenditures by the end of the summer and, accordingly, have already launched our letter of intent to book the most critical vessels for module transport from the Asian yards to Murmansk.

Construction activities at the Murmansk LNG yard are proceeding according to our work plans, so there's really not much new activities to report. We completed the installation of steel structures and walls through the GBS shop and installed the internal utilities networks. Work is underway for the external infrastructures such as water supply system, sewage system and electricity system. We completed the rebar] and form workshops and transferred access to these facilities to the main GBS contractor, [J. D. Strachan]. We commissioned all 4 of the concrete batch plants, as well as meeting the peak rate of production test at the rebar workshop.

The joint venture SAREN has already started preparatory works. Work will commence shortly on the base casting of the first GBS platform. [All works] according to our schedule to start train #1 in 2023.

We commenced full-scale LNG production at our Cryogas-Vysotsk plant in the second quarter and began selling small volumes of LNG to the Baltic and Scandinavian markets. During the second quarter we sold 24 tankers comprising 75,000 tons and loaded 38 trucks, for 640 tons, with LNG. The entity's general market strategy provides for the loading of bunkering vessels, small wholesale LNG sales and LNG sales for motor fuels. Cryogas-Vysotsk is still at a relatively early stage of its operations, as is the LNG market to replace fuel oil with LNG for bunker fuels. We will assess our market and options as the use of LNG as bunker fuel gradually evolves with the implementation of the new IMO 2020 standards.

We achieved good success in our exploration program during the first half of 2019. Exploration activities is important for a number of reasons. It provides a pipeline for future development activities as well as indicating the size of production and resource potential for future LNG projects. Tonight we will share some of the testing results from prior activities combined with some ongoing works that we will continue throughout 2019 and beyond.

We completed the testing of the first well to target the lower [Jurassic] horizon at the South-Tambeyskoye field and have commenced long-term production tests at the well. The horizontally drilled exploration well #172 using a 5-stage hydrofracture flowed natural gas at a rate of 450,000 to 500,000 cubic meters per day, with a condensate concentration factor of 250 grams per cubic meter. We will drill at least 3 more Jurassic wells at the field and preliminarily believe based on initial test results that we can extend the liquid plateaus at the field. Obviously we will need to confirm this preliminary assessment with actual result tests from the next 3 wells, but this initial well confirmed the productive capabilities of this target horizon.

We also had very promising preliminary results at our Gydansky field with the completion and testing of exploration well #132. Based on only the vertical test of this well without fracking, well #132 achieved the productive flow of approximately 100,000 cubic liters per day, with a condensate concentration factor of 210 to 220 grams per cubic meter at the Achimov layer. We're currently drilling exploration well #136 and we will test this well in the latter part of the third quarter.

We recently published a press release announcing the success of an exploration at our Arcticgas joint venture. In the second quarter we completed and tested exploration well #U2802, targeting below Achimov formation at the Urengoyskoye field. We completed an 8-stage hydrofracting program utilizing a record-high proponent (sic) [proppant] volume of 2,187 tons, with a total length of 5,624 meters and a horizontal section of 1,500 meters. A unique wireless inline monitoring technology using marked proppant was implemented, as well as a permanent downhole pressure and temperature gauges in the production stage to monitor real-time data. Utilizing state-of-the-art technologies, the exploration well achieved a daily flow rate of 1 million cubic liters of natural gas and 500 tons of gas condensate, confirming a significant prospect to develop the lower Achimov formation.

We also completed the drilling of exploration well U2804 targeting the lower Achimov deposits at the Urengoyskoye field in a record 43 days. The total length of the well is 5,405 meters, with a horizontal section of 1,536 meters. We drilled the horizontal section of the well in only one trip, which is an industry record, and we achieved substantial drilling rates of 16.6 meters per hour. Drilling the horizontal section in one trip means a quicker well completion, which is positive for both the client and the drilling company, particularly if the drilling company is drilling on a turnkey contract. We will test this well in the upcoming months. We will provide regular updates regarding our exploration program during the upcoming conference calls.

We also had a very active period of development drilling in the second quarter of 2019 relative to the prior year. We drilled and completed 44 production wells in this reporting period versus 23 production wells in the corresponding 2018 period, representing a 91% growth in drilling completions. We plan to drill approximately 161 wells in 2019 according to our development plans and as of the first 6 months of 2019 have completed 71 wells, or 44% of the planned program.

In the second quarter 2019 we remained focused on the North-Russkoye field as we prepared for this field to commence initial production in the latter part of 2019. We have already drilled 15 wells out of a planned 15 production wells to achieve plateau production at this field, as well as drilled 6 production fields at the East-Tazovskoye field, which is set to commence initial production starting in 2020. Presently we are building a gas treatment unit, a gas deethanization unit, as well as the utility networks and pipelines. Those works are a continuation of the activities reported in the first quarter conference call. The gas pipeline link is completed and connected to the UGSS and preliminary testing is underway. We are targeting natural gas production growth of 8% to 10% in 2019, with liquid production slightly increasing year-on-year. With the upcoming launch of the North-Russkoye field and subsequently the other fields comprising the North-Russkoye cluster, we will replace production declines in our legacy core fields in both natural gas and liquids.

We will have a series of new greenfield domestic production commencing toward the latter part of 2019 and throughout 2020. Yesterday we announced the commencement of natural gas production at the South-Khadyryakhinskoye field. This field will add about 1 billion cubic meters to our annual production at plateau levels. In addition, we will commence production at the (inaudible) 5-1 layers at the [Sonbuskie] license in the fourth quarter 2019, eventually reaching production of 4 billion cubic meters of natural gas and more than 2 million tons of gas condensate at production levels in the mid-2020s.

Our operational and financial results of the first 6 months were relatively strong, despite weakening global commodity prices, particularly weaker natural gas prices in Europe and Asia. Moreover, our quarter-on-quarter results were also impacted by seasonal adjustments in demand from peak winter months. But overall, we were very pleased with our solid and operational financial results in the second quarter and for the first 6 months of 2019.

In the second quarter of 2019 Brent crude oil averaged approximately $69 per barrel as compared to $74 per barrel in the prior year, representing an average decline of 7%. Prices for crude oil improved by roughly 10% per barrel between the first and second quarters 2019, but remained volatile. We expect benchmark crude oil prices to remain volatile for the foreseeable period as we experience short-term demand/supply imbalances, technical corrections, as well as increasing geopolitical tensions.

Global natural gas prices were very weak in the second quarter and was well documented and discussed in various research reports and news stories. The average NBP price per MMBtu declined on average by 33% over the first half of 2019 as compared to the corresponding period in 2018 and quarter-on-quarter by roughly 44%. We expect that the current low LNG prices will persist throughout the remaining summer season, potentially limiting spot price increases in the third and fourth quarters 2019.

The futures markets, although not perfect, indicate a seasonal recovery in the upcoming winter months. Currently natural gas inventory levels are above seasonal averages in both Europe and Asia. This fact combined with the new project commissionings expected during the year could put further downside pressure on spot prices in the market.

Our total oil and gas revenues were approximately RUB 216 billion, or 11% higher than in the second quarter of 2018. Natural gas represented 46% of our total oil and gas revenues, whereas liquids accounted for the remaining 54%.

We produced 149 million barrels of oil equivalent in the second quarter, or approximately 1.64 million barrels of oil equivalent per day. This represented a daily production increase of 13% year-on-year, but remained relatively flat quarter-on-quarter.

Our oil and gas revenues decreased quarter-on-quarter by 6.7%, primarily through a combination of factors. For natural gas we had a decrease in volumes sold on the Russian domestic market due primarily to seasonality, offset slightly by stronger prices and a shift in sales mix more towards end customers.

For LNG we increased our sales volumes quarter-on-quarter but had an average decline in realized prices by 29% in US dollar terms. The commencement of LNG production at Yamal in December 2017 and the subsequent launches of LNG trains #2 and #3 in 2019 ahead of schedule had a positive impact on our natural gas sales as we primarily sold early volumes at 60% equity. We began to sell more volumes from LNG trains #1 and #2 on contractual terms rather than spot sales as the year progressed. Declining spot prices did not materially affect our sales volumes sold under long-term contracts as prices under these contracts are essentially based on oil-linked price formulas. We anticipate by the end of the first quarter 2020 we will sell the majority of all volumes produced by Yamal LNG on contractual terms with some residual volumes sold via the spot market, including those volumes produced over the nameplate capacity of the facility. Furthermore, we anticipate that we will most likely sell the upcoming volumes produced from LNG train #4 when formally launched on the spot basis.

Our international LNG sales revenues increased year-on-year by RUB 28 billion, or by 296%, largely attributable to an increase in volumes sold by roughly 3 billion cubic meters, which was offset by a 29% decrease in the average realized price in Russian ruble terms. Domestically we had an increase in both year-on-year volumes sold and averaged realized prices.

Our natural gas sales volumes increased by 4.9 billion cubic meters, or by 8.6%, whereas our average price per mcm increased by 4.2%. We sold 96% of our domestic gas to end consumers and 4% to [ex-field] traders. We do not have the same level of price volatility on the domestic market, which makes revenues more predictable.

We sold 15.1 billion cubic meters of natural gas on the Russian domestic market and 3.7 billion cubic meters in the (inaudible) LNG sales during the second quarter 2019, accounting for a year-on-year increase of 3.6 billion cubic meters, or 24%. Our combined average natural gas price of RUB 5,329 per mcm increased year-on-year by about 21%, reflecting the higher mix of LNG sales on our gas portfolio.

Natural gas netbacks both domestically and internationally increased by 38% year-on-year but declined 8% quarter-on-quarter. The decrease in the quarter-on-quarter netbacks were primarily to decline in spot LNG prices between the periods as we sold approximately 28 cargoes under spot sales from the early start-up volumes.

Despite the decline in spot LNG prices in key markets, we remained profitable due to our low operating and lifting costs. This distinction is important as we develop our future LNG platform either relative to other global projects discussed or currently in the project pipeline. In the respective reporting periods, sales of international markets represented 19.5% of our total gas volumes sold and 38% of our natural gas revenues. Our average netback was 4x higher for volumes sold internationally than netbacks received on the domestic market as compared to the prior year. Our average netback sold internationally between the first and second quarters 2019 decreased by 32% due to the weaker LNG spot sales, although we partially offset this decline by higher volumes sold in the current period. Even with weak spot prices LNG volumes sold internationally contributed significantly to our revenues and netbacks for natural gas. This demonstrates the importance of expanding our LNG platform.

We injected approximately 614 million cubic meters into underground storage versus 1.2 billion cubic meters in the prior year. We withdrew 1.4 billion cubic meters in the first quarter. We had approximately 1.4 billion cubic meters in underground storage or LNG in transit at the end of the current reporting period versus 813 million cubic meters at the 31st of March 2019 and 2.2 billion cubic meters at year-end.

We sold slightly more than 4 million tons of liquids in the reporting period, representing a year-on-year decrease of 3.3% versus a quarter-on-quarter increase of 3.9%. We exported 59% of our total liquid volumes, or 2.4 million tons, which was equivalent in percentage terms to the liquid volumes exported year-on-year and quarter-on-quarter.

Our average commodity prices somewhat improved during the reporting period but was lower for our product range due to weak underlying contract prices relative to the prior year.

Our operating expenses increased by 16%, which again was attributable to the significant increases in hydrocarbon purchases. Purchases accounted for approximately 83% of the comparative increase in our operating expenses. We purchased hydrocarbons primarily from our joint ventures rather than third parties. This distinction is important because money circulates within the group and we now receive significant dividend payments from our joint ventures. Most of the remaining operating expenses, including G&A, was consistent with our expectations for the reporting period.

We generated RUB 80 billion in positive free cash flows during the current reporting period. This reflects the strength and resiliency of our operating cash flows, driven by volumes and netback growth with LNG sales and a fairly consistent and reliable core domestic business that is cash generative. We have been able to increase our positive free cash flows despite increasing capital expenditures in our reporting periods.

We spent RUB 31 billion in cash on our capital program, representing an increase of RUB 9 billion, or 42%, over the prior-year period. It is important to note that with the recent sale of participation interest in Arctic LNG 2 we effectively deconsolidated this subsidiary and eliminated the capital expenses on the group's consolidated statements this reporting period. We now account for Arctic LNG 2 as a joint venture.

The increase year-on-year in capital expenditures related to 2 main projects, the LNG construction yard at Murmansk and the North-Russkoye license area. These projects accounted for RUB 18 billion, or 49% of our total capital expenditures in the current reporting period. We allocated the remaining capital spent over a range of development projects across our project portfolio, some capitalized exploration work and our new office complexes in Moscow and Novy Urengoy. We spent roughly RUB 43 billion in the first quarter 2019, or roughly [16%] lower on a cash basis quarter-on-quarter. At the end of the first half 2019 our capital spend totaled RUB 85 billion, inclusive of RUB 79 billion for exploration and development projects, RUB 2 billion on acquisition of mineral license and RUB 4 billion on the right-of-use assets, namely vessel charter.

Our capital program for 2019 was originally projected to reach approximately RUB 185 billion, or a 2-fold increase year-on-year. But for tonight's call we will revise upwards the 2019 capital program to approximately RUB 200 billion to account for the additional unplanned work at our new LNG project, Obskiy LNG. Preliminarily Obskiy LNG will consist of 3 liquefaction trains at 1.6 million tons per train, or 4.8 million tons per annum. The project will use a modified version of our Arctic Cascade liquefaction technology and will utilize the hydrocarbon resource base of the West [Sayahinskie] and [Berkleeterinsky] field located southwesterly of the Yamal LNG's South-Tambeyskoye field.

The initial plan is to connect the 2 fields via a pipeline to the Yamal LNG complex where we will construct the LNG trains. The ABC1+ C2 reserves for the combined 2 fields is 377 billion cubic meters of natural gas and 9.1 billion tons of gas condensate. We completed the run of 3D seismics at the fields during this quarter and will interpret this information in the second half of 2019.

Our EBITDA for the second quarter of 2019 totaled RUB 116 billion and was 14% higher than the prior year and roughly 2% lower relative to the first quarter of 2019. Our operating cash flow exceeded our cash used to finance capital expenditures by 3.6x despite the fact that we have increased our capital spend on our capital program year-on-year by 42%. We generate sufficient operation cash flows to fund our capital program, service our debt payments and liabilities as they become due and disburse semiannual dividends to shareholders.

Our balance sheet remained very strong in the first half of 2019. We improved all of our credit metrics during the period and again demonstrated a solid balance sheet to support our international and domestic credit ratings. Our net debt to EBITDA stood at 0.28x.

We concluded another solid quarter of operational financial results in a period of weak natural gas prices in key consuming markets. Significant volatility in commodity prices represents an enormous challenge to many oil and gas producers, particularly those companies operating in a high-cost environment. Earnings pressures will continue unabated if we have a prolonged period of lower commodity prices.

Yamal LNG has been an enormous success in the global LNG market. We have dispatched 257 cargoes representing 18.8 million tons since the commencement of LNG production 19 months ago. Essentially the LNG complex is loading and dispatching LNG cargo every 32 hours to all key markets. And recently we opened the 2019 summer navigational season on the Northern Sea Route with the Arc7 ice-class tanker the Vladimir Rusanov. This represents the second consecutive year where one of our LNG tankers commenced the eastbound navigational season on the Northern Sea Route.

Arctic LNG 2 has completed our target shareholder structure by selling 40% of the project to Total, CNPC, CNOOC and a consortium of Mitsui JOGMEC. This was our strategic vision and now allows us to focus on the final investment decision and the financing structure. The success of Yamal LNG and our ability to deliver cargoes to the Asian-Pacific market year round makes our LNG platform highly attractive to our Asian partners.

We welcome the opportunity to expand the number of countries participating in our LNG projects. We are still considering other potential partners with this game-changing project beyond the 40% already sold. If another partner decides to enter the project post-FID, we will consider that at a higher project valuation. We will report the specific details in our third quarter results on the recently announced closed transactions, but I would like to reiterate again that we based these transactions on the valuations and terms already announced with Total.

We also successfully launched our Cryogas-Vysotsk LNG project in the second quarter of 2019. It is still very early in the project's operational cycle, but we will carefully assess the bunkering market as IMO 2020 fast approaches. Transport fuels are transitioning towards clean burning natural gas and we believe we can capture a niche market in this area.

The next couple of years will be a volatile period for LNG producers as the current oversupply puts downward pressure on global LNG prices. Lower LNG prices are not always bad though, and we remain optimistic about the future LNG demand and our LNG platform. NOVATEK has one of the lowest lifting costs in the global oil and gas industry. We will achieve some of the lowest liquefaction costs in the industry with our Arctic LNG 2 project. In addition, we will further reduce our transport costs to key Asian importing markets by optimizing our logistical model with the proposed transshipment terminals in Murmansk and Kamchatka.

NOVATEK remains highly competitive in the Asian, Latin American and European markets. Low LNG prices will stimulate LNG demand. LNG prices will eventually rebound to a more sustainable level. Cost competitiveness will be the key to sustain sufficient demand growth. Future LNG projects must be cost competitive to achieve sufficient profitability to justify investment decisions. What we have created at NOVATEK is game-changing in the true sense of the word. Our dedicated Arc7 ice-class tankers represents one of the newest LNG fleets in the world and their vessel performances makes the Asian-Pacific market a prime candidate for increasing LNG volumes. Our prolific conventional hydrocarbon resource base on the Yamal and Gydan peninsulas offers low-cost natural gas feedstock to our future LNG projects, ensuring the cost competitiveness of our projects. Our use of technology and innovation to conceptualize an LNG project based on the scalable, gravity-based LNG platforms redefines the LNG model. This new concept using gravity-based platforms is game-changing.

Over the past 19 months we have established ourselves as a key player in the LNG market. Our LNG has made a noticeable difference and we are expanding our efforts to penetrate key markets like our recent announced agreement to form a joint venture with Sinopec and Gazprombank to market natural gas in the Chinese domestic market. We will assess select opportunities to facilitate downstream demand for natural gas and capture more margins along the value chain.

It has been profoundly rewarding and equally challenging to be at the forefront of the next wave of global LNG projects. We are building a sustainable LNG model in a dynamically changing world. New trade patterns are emerging. Liquidity will redefine the traditional LNG buyer/supplier interface and new intermediaries will emerge that create trading strategies and risk management tools. Swaps and other derivative arrangements will no doubt influence commercial arrangements.

There are 5 key LNG-producing centers in the world that will meet the growing demand for flexibly priced and flexibly delivered natural gas in a world transitioning from coal to clean-burning gas. The Russian Arctic zone is one of them. We estimate that the main LNG producing centers can produce in excess of 500 million tons of LNG by 2040.

Global demand for natural gas is also increasing. Industry participants forecast LNG demand will increase to around 700 million tons by the mid- to late 2030s. We agree with these demand forecasts. Therefore, we do not operate in a zero-sum game. Competitively priced LNG provides real solutions to meet climate change challenges. We need to remove the geopolitics out of the dialogue and let market forces determine the best projects to meet this growing demand for natural gas.

We are now operating at full capacity at Yamal LNG. We successfully launched a Cryogas-Vysotsk LNG complex . . .

Operator

Ladies and gentlemen, please stand by.

(technical difficulty)

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

We got cut off at 60 minutes for some reason. But I'll start where I left off.

I said we are now operating at full capacity at Yamal LNG. We successfully launched a Cryogas-Vysotsk LNG complex and we sold a target 40% stake in Arctic LNG 2 to a great group of partners. We will make the FID decision on Arctic LNG 2 in the third quarter. We will also commence initial design and pre-FEED work on our upcoming Obskiy LNG project later this year.

Our exploration efforts will further delineate our hydrocarbon resource base to support our future LNG projects. Accordingly, we will increase the number of fields appraised this year for our upcoming International Reserve Report.

We would like to thank everyone for attending tonight's conference call and your continued support of NOVATEK. The first half of 2019 has been exciting for us. The remainder of 2019 will be equally exciting but challenging for the global gas industry. Operationally we will launch a new major domestic gas field, the North Russkoye field; continue our exploration efforts; complete train 4 at Yamal LNG; and begin construction of the first GBS unit at Arctic LNG 2.

Financially we received our first interest payment for Yamal LNG and the facility is generating sufficient cash flows despite the weaknesses in gas prices to make considerable cash payments this year. We also received our first dividend payment, totaling RUB 38.5 billion, from Articgas, which was a new milestone for this significant joint venture.

We will soon finalize our completion tests at Yamal LNG when we receive the remaining Arc7 tankers and demonstrate that all 15 tankers are operating to satisfy the shipping completion test. 11 Arc7 tankers are now operating and delivering LNG to markets. In fact, more than 25 countries consume natural gas molecules from LNG produced at our Yamal LNG facility, an extraordinary accomplishment and a game-changer for Russian LNG produced from the Russian Arctic zone and for us at NOVATEK.

A new chapter in our investment story will emerge. We will significantly increase our future dividend payments. Historically we have shared our success by increasing dividend payouts each year since 2005. We have consecutively increased our dividends paid 29-fold since 2005, representing a compound annual growth of 30%. Once the final shipping completions is completed and satisfied we will increase the dividend payouts. We are committed to increasing total shareholder returns.

We look forward to our future challenges, the opportunities and the rewards. Thank you. And we're open for questions and answers.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll go first to Karen Kostanian of Bank of America.

Karen Kostanian - *BofA Merrill Lynch, Research Division - Head of EEMEA Energy Research & Head of the Russian Research Department*

Yes. Mark, thank you very much for the presentation. I have one question about [Ob] LNG since you started talking about this. Do you have a preliminary timeline in mind in terms of the launch of what I believe is going to be 3 trains? That's my first question.

And are you considering also a capital structure with partners for (inaudible) or are you going to do that yourself?

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

On your first question -- I mean first part of your question, sorry -- is it's expected to be launched pretty much in line with Arctic LNG 2, so probably around 2022, 2023 timeframe for Obskiy LNG. We expect to make an FID decision sometime in the first half of 2020 next year based on the results that we do in the feed, pre-feed and design work this year.

Your second part of your question, I think it's too early at this particular stage to start talking about partners at this point. We will obviously consider, but I think it's too premature.

Operator

We'll go next to Thomas Adolff of Credit Suisse.

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

Thanks for the presentation. I've got 3 questions, please. Just firstly on CapEx, I may have missed it. The RUB 200 billion, is this all cash CapEx? And what's driven this increase and what can we expect for 2020?

And then secondly, in relation to Yamal train 3, most -- kind of all the volumes currently are sold into the spot market. Where do they go? Is that predominantly into Europe? And do you have contracted [re-gas] in Europe?

And then finally, as Yamal LNG seems to be paying a dividend to shareholders and Arctic LNG partially funded through proceeds from the asset sales, do you have a self-funded LNG business now? And if so, would it make sense to split up the business into LNG-only and domestic-gas-only businesses?

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

Thomas, can you repeat the third part of your question? I'm trying to write it down so I can better explain.

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

The last one, you said? Yes. So basically . . .

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

Yes, the third part of your question.

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

Yes. The third one is basically now that Yamal LNG is paying a dividend and Arctic LNG too, kind of partially funded through proceeds from asset sales, whether you have a self-funded LNG business today and, if so, would it make sense to split up these businesses into LNG-only versus -- and domestic-gas-only businesses, so 2 different businesses.

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

Okay. The 200 -- the first question on capital expenditures, I said that the increase in capital expenditures was primarily related to the unplanned work that we're doing at the Obskiy LNG that we've announced. There is not an increase in capital programs for other projects. It's specifically focused on the additional unplanned work at the Obskiy LNG plant. Okay?

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

Yes.

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

Second question, train #3, where are they going. I think we have 2 -- I talked about depends on if they're going to Asian market. I mentioned that we have a series of tankers that are expected [to go] both on what I would say contracts plus about 5 to 10 spot deals. They will go to the Asian markets.

I think the other question too is, like, sometimes when we do the transshipment to a facility, whether it's in Europe -- the 3 main ones that we used earlier to be ship-to-ship transfers, they're going this first [time]. And I said we sold -- at least on molecules, at least the way we understand it and it's been confirmed by our marketing people, that our molecules have made it to 25 different countries. But I can't specifically tell you exactly where they'll go onto the future. But that's where so far it's been in the past. All right?

In terms of splitting the business, I assume -- are you talking about having a listing of just LNG and/or -- and a listing just of a company which sells on the domestic market?

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

Yes.

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

Is that what you're implying? No. The answer . . .

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

(inaudible) play.

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

. . . is no.

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

Why not?

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

No. The answer is no. It's not -- we don't have any interest to do that at this particular point in time. We considered it earlier and at this particular juncture we decided that that's not going to be the business model we want to put forth.

Operator

The next question comes from Ron Smith of Citi.

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

If you wouldn't mind returning to Obskiy and (inaudible), do you have a general estimate yet on the capital requirements for that entire project? And if not, if you could at least give us an idea how much it might cost to either build the 2 storage tanks that I've seen reported and how much you might be expecting per ton of liquefaction, I'd appreciate it.

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

Ron, I think it's -- as I tried to allude before, we're in the design stage and the pre-FEED stage. So I think it's premature to really give those types of information out. And it's definitely premature to disaggregate the project into what is it going to cost us for construction of tanks, the 2 tanks that you referred to. So I think you just need to let us complete this work over the course of this remaining year and we'll be glad to put that number out as soon as we get done with the pre-FEED and start into the FEED study. Because we know we're going to have to make that announcement sometime in early 2020 if we plan to do the FID in 2020. So I think it's really premature to talk about all the cost structures.

Operator

(Operator Instructions) And we'll go next to Olga Danilenko of Prosperity.

Olga Danilenko - *Prosperity Capital Management Ltd - Director of Oil and Gas*

I have 2 questions. The first one is on gas prices. You mentioned briefly in your presentation that you expect lower gas prices to continue throughout summer and potentially impacting the second half of this year. So my question to you will be would you consider, would you think it is worthwhile to hedge using the futures curve for second half '19, maybe first half '20 prices and that liquidity [perhaps allows] to hedge it.

And my second question relates to the dividend from Arcticgas, which you also mentioned. My question is, is it paid annually or we may expect some more distributions from Arcticgas later this year?

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

Well, the second part of your question is easier. Yes, we will expect dividends paid out more from Arctic LNG 2 -- I mean, Arcticgas, excuse me, not Arctic LNG 2. Articgas. Sorry about that.

The first question is much more complicated, because we're really not at that stage in the business to start looking at, because we don't -- we look at hedging obviously. Do we hedge a gas hub price or do we hedge a crude oil price is really the only choice we have at this particular juncture. And I don't think at this point in time, given the volumes that are being sold that we're really going to start executing some longer-term hedges at this particular point. I don't think we have the liquidity in our own position I think because we're going to pretty much going to be rolling off the 60% equity volume. And then if we go back into the long-term contracts, the long-term contracts have already linked to oil indexes. So I just think at this stage right now I don't think we're going to be looking at committing ourselves to sort of a long-term hedging strategy.

With that said, as we increase our volumes with Arctic LNG 2 and the Obskiy project and some of the other futures, obviously if NOVATEK moves more towards a portfolio player with a larger volume of equity LNG to sell, I think obviously we will consider that. And I think Mr. Mikhelson has already talked once before that longer term we're looking at maybe a split of 50% spot versus 50% long-term contracts. But I think given that where the liquidity is today, I don't think we have made that decision. But clearly we have looked at hedging strategy and what it offers to us as a company.

We have also looked at swap arrangements, too, to consider a way of increasing possibly the profitability of each cargo and targeting certain markets. But, again, they're not -- they're something that's at the very infancy of trading. And this is what we see as the market evolves, as the industry evolves more, as liquidity increases, et cetera, and contracts become more standardized, et cetera, in the process, I think we'll see more of these types of derivative activities as well as more risk management strategies put in place. But right now I would say we don't.

We do it in our European trading operations for the gas that we sell on the European market. But on the LNG strategy today, we're just studying it. I don't think we've made that decision to move forward yet.

Operator

(Operator Instructions) And we'll go next to Timothy Riminton of Barclays.

Timothy William Riminton - *Barclays Bank PLC, Research Division - Research Analyst*

I just have a quick question on the non-financial guarantees relating to Yamal LNG. I just noticed that the euro guarantees increased to 7.9 billion in this quarter compared to 7.2 billion at the end of the year. Why was this the case? Because we were under the impression that they would start gradually dropping off as the various tests were met.

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

Yes. I think your original assessment -- your original comment was correct. But we withdrew additional monies on the project financing arrangement. And that's why there was an increase in this particular period.

Timothy William Riminton - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. So you still expect them to drop away materially as the tankers and ships come online toward the end of the year.

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

Yes. I think that's probably a right assessment.

Timothy William Riminton - *Barclays Bank PLC, Research Division - Research Analyst*

(inaudible) . . .

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

This goes back -- yes, this goes back to the question on the shipping completion tests.

Timothy William Riminton - *Barclays Bank PLC, Research Division - Research Analyst*

Yes.

Operator

And we'll go next to Anna Kotelnikova with Sberbank.

Anna Kotelnikova - *Sberbank CIB Investment Research - Junior Analyst*

I have one question. You had very strong contribution to EBITDA on your (inaudible) of RUB [46 20] billion in second quarter and almost RUB 100 billion for the first half. So could you give some guidance approximately how much of this is attributable to Yamal LNG? That's it.

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

First of all I would ask the question and I would assume everybody was pleased and happy with the contributions of the dividends from Articgas as well as the start of repayments of interest at Yamal LNG. I think everybody has been waiting for this moment to occur. To be able to provide you with splits between our joint venture operations, we're just not providing that granularity of information at this particular point in time. I think we should just be happy that these joint ventures are now at the stage of their life cycle that they can start paying back money in the form of dividends to us in terms of the interest payments as well as eventually the loan repayments start process at Yamal. But I'm not going to get into the point of separating who's contributing what at any particular point in time.

Operator

We'll go next to Ron Smith of Citi.

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

Yes, Mark. One more question. I'd like to go back to your statement right at the end of your prepared comments. You said that NOVATEK is about to enter a new phase -- I'm paraphrasing -- that you would significantly increase your dividend payments once -- if I got it right, once the final shipping completion test is satisfied. I presume first that it's a shipping test for Yamal LNG. Please correct me if I'm wrong.

And, second, when you say significantly increase, I mean, are you talking about just increasing your targeted payout from, say, 30% to 40% or 50% as a lot of your peers in Russia are now doing? If you could give us a big more detail. And on the -- is that a first quarter announcement or if you could give a bit more details I'd appreciate it.

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

Welcome back, Ron.

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

It's always good to talk to you.

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

That's okay. It's okay. I understand. No. Look, we have stated many, many times in the past our dividend policy says at least 30%. That is the minimum level of dividends that we would pay. And as I tried to demonstrate at the very end we have paid -- in the presentation that's included with the conference call there's a slide in the Appendix section that shows each and every year what we paid in dividends. And you can see the absolute growth. So when everybody's talking about dividends being paid by Russian entities, we have been paying dividends throughout our whole public life, for a company that has shown exceptional growth.

So we're just at that stage now where we complete -- we finish the completion tests at Yamal LNG as you rightly alluded and that's what this relates to. The company is generating cash. So if we have -- the policy is basically capped today because of these completion tests, once we finish them we increase the dividend based on the cash flow that the company is achieving these days. And so that's why I would say that beginning sometime probably in the -- depend on, like, April or so timeframe when we complete the last sets of tanker movements, because it's really based on showing all 15 tankers operating in this particular winter season, I think the plan would be almost immediately with a declaration of the dividends for the first half results of 2020 to be above the 30%. But we're not coming out with a new policy, because the policy only accounts for this -- it accounts for our ability to significantly raise the dividends above this 30% based on the results.

So I suspect that we'll know very early on in the first quarter how we're doing in relation to this test. And so I assume by the time we meet and talk about the first quarter numbers of 2020 we would already have completed this particular test and we can kind of give you an indication that this will indeed be related to the first half dividends.

But I can tell you right now, it's management's intention, it's the shareholders' intentions. Everybody wants to see us increase the amount of the dividend payouts. And that's (inaudible) -- that's why I specifically ended tonight's discussion on this one particular point because I know it's an important point that many, many investors as well as many analysts, including yourself, have focused on in the Russian oil and gas industry today. Last year you can see from 2018 to 2017 (sic) [2017 to 2018] we increased our dividends from RUB 14.95 per share to RUB 26.06 per share, was a significant increase year-on-year. But at the same time, it still equated to roughly about a 3% dividend yield. But that dividend yield was also impacted by the 42% increase in our share price. So our total shareholder returns for 2018 was roughly 45%. And so we could have had a higher yield if our share price didn't move as much as it did last year. But the company is still growing company. It's part of our business and we're seeing that. We will try to balance and increase total shareholder returns by paying more dividends. But I think we have to just wait and, as I mentioned complete the tests. Make the announcement basically in either year-end results, first quarter results, that these tests have been completed and then I think we'll look at this for the 6-month numbers, first half of 2020, where we actually see the effect of this increase beyond the 30%.

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

Sounds good, Mark.

Operator

We'll go next to Andrey Gromadin with Sberbank CIB.

Andrey Gromadin - *Sberbank CIB Investment Research - Analyst*

I have a follow-up actually on [EBITDA] distribution from (inaudible). I understand that you don't give the breakdown or guidance on kind of contribution, but basically (inaudible) report its financials into each time. So you'll see a number. Maybe you can give us kind of a better feeling the estimated amount (inaudible). (inaudible) billion for first half for NOVATEK's share, roughly $2 billion for the whole project for the first half. Is it close to (inaudible) [reasonable]?

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

Like I said, I'm not going to speculate and provide numbers that based on things that we have to wait to see what the macroeconomic situation looks like in terms of prices we'll receive in the second half. We're moving away -- as I tried to -- we're moving away from spot numbers to long-term contracts. All right? Those are oil-linked prices. We have condensate sales that we're doing in a particular project. We have a lot of factors that are going to impact what the EBITDA numbers will be. And we're just not going to give the joint venture by joint venture breakdown. I'm sorry.

Operator

And at this time we have no further questions in the queue.

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

Okay, well thank you very much for tonight's call. And we look forward to addressing you in October with the 9 months' numbers. But, again, we'd like to wish everybody a good remaining summer. And we'll see you later on. Thank you very much.

Operator

And, again, this does conclude today's call, ladies and gentlemen. We appreciate everyone's participation today. And you may now disconnect.
