

# KEY RISKS AND THEIR MANAGEMENT

## 1 OPERATING RISKS

### 1.1 RISKS ASSOCIATED WITH GEOLOGICAL EXPLORATION OPERATIONS

One of the Company's key strategic objectives is growth in the raw hydrocarbon resource base in quantitative and qualitative terms in order to ensure the required level of production, which in turn largely depends on the success of geological exploration. The main risk associated with geological exploration operations is the failure to confirm the planned level of hydrocarbon reserves and objective deterioration in the quality of the resource base. Another important factor is geological exploration work in different geographic regions, including regions with adverse climatic conditions and environmental restrictions, which often leads to the risk of increased costs. Estimates depend on a number of variable factors and assumptions, including the following:

- > the correlation of the historical level of productivity in the region of production with the productivity of other regions that are comparable in terms of characteristics;
- > the interpretation of geological exploration data;
- > the effect of the requirements of government structures and legislative acts.

Gazprom Neft manages license-related risks as regards oil and gas exploration by making timely changes to geological study design documents.

#### RISK MANAGEMENT MEASURES

Gazprom Neft has considerable experience conducting geological exploration work and employing the latest geophysical methods to prospect and explore hydrocarbons as well as advanced technologies in the drilling and development of fields, which results in the decreased probability of such risks. The Company has hired the auditor DeGolyer & MacNaughton to perform an independent audit of reserves based on the estimates of the Gazprom Neft's subsidiaries. Gazprom Neft actively cooperates with government structures at the federal and regional levels on matters concerning the sustainable use of subsoil resources.

- > For more, see the 'Geological Exploration Work' and 'Production and Raw Materials Base' sections

### 1.2 LICENSING RISKS

The Company performs its subsoil resource operations on the basis of special permit documents and licenses for the right to use subsoil sites, which specify the intended use (type of subsoil use), spatial boundaries, dates and mandatory conditions for the use of the subsoil resources. Existing law envisages administrative sanctions for the unlicensed use of a subsoil site, and there is a risk of criminal liability in a number of cases.

The failure to meet the conditions for the use of subsoil resources may entail administrative liability with the imposition of fines, while the repeat (continued) violation of significant conditions for the use of subsoil resources may entail the risk of the early termination of a license in accordance with Article 23 of Federal Law No. 2395-1 dated 21 February 1992 'On Subsoil Resources'. If the right to use subsoil resources is terminated prematurely, the Company bears both reputational risks as well as material losses related to the expenses incurred on acquiring the right to use the subsoil resources, investments to develop the subsoil site and decreased capitalization associated with the loss of the resource base.

#### RISK MANAGEMENT MEASURES

The Company views the prohibition on the unlicensed use of subsoil resources as a categorical imperative. The Company provides end-to-end surveying support for all stages of prospecting, exploration and production drilling as an exhaustive measure to prevent the unlicensed use of subsoil resources.

The Company's Subsoil Use Monitoring System (SUMS) automated complex with its well-developed matrix for the risks involved with fulfilling the main (significant) conditions for the use of subsoil resources is the main risk management tool that is used to assess the current state of risks using matrix indicators and plan for an acceptable level of risk in the future.

Standing Regional Licensing Commissions (RLC) review the status of current and potential license risks and the implementation of targeted measures to mitigate such risks on a quarterly basis.

One of the measures aimed at reducing the level of licensing risks was the transition from risk management to managing licensing obligations. The basic idea of managing license obligations is to adjust the physical volumes of specific types of geological exploration and development indicators that had previously been strictly recorded in the conditions for subsoil resource use in accordance with the requirements of design documents (for example, an associated gas processing facility or raw hydrocarbon production levels). The Company's goal is to update the entire license portfolio with the exclusion of specific types, volumes and indicators from the conditions for the use of subsoil resources.

The CEOs of the Company's subsidiaries are responsible for retaining licenses for the right to use subsoil resources with the relevant objectives recorded at their training and production centres.

### 1.3 PROJECT RISKS

The Company continuously develops and implements investment projects that aim to achieve strategic goals, in particular growth in the extraction of raw commodities and improvements in the quality of the products manufactured. When implementing projects, the Company encounters a variety of risks that could lead to a violation of the deadlines and/or the increased cost of the project. The main factors behind such risks are poor planning, violations of the project terms and safety requirements by contractors as well as new circumstances (increased cost of materials, errors in the assessment of infrastructure conditions and switching equipment suppliers).

#### RISK MANAGEMENT MEASURES

The Company manages these risks, while paying special attention to the development and coordination stages of investment projects. In 2014, a risk management system was introduced to the process of preparing and implementing major projects. This system is based on the generally accepted approach in the global industry

to establishing a project's value using the Stage-Gate process with a risk assessment of the project at each of its stages. Requirements for contractors are based on a risk assessment and also take into account the requirements of the laws of the country in which the project is being implemented. In addition, the Company has established a project monitoring system.

### 1.4 RISKS ASSOCIATED WITH HUMAN RESOURCES

The Company's business depends on highly skilled key employees, and a lack of skilled labour, in particular in engineering and technical areas, may lead to risks associated with a shortage of personnel. The Company's success largely depends on the efforts and abilities of key employees, including skilled technical personnel, as well as the Company's ability to recruit and retain such personnel. Competition for personnel in Russia and abroad may intensify due to the limited number of skilled specialists on the labour market. The inability to recruit new skilled personnel and/or retain existing skilled personnel could have a negative effect on the Company's appeal as an employer. Demand for skilled employees and the related expenses are expected to grow, thereby reflecting the considerable interest in such resources from other industries and social projects.

#### RISK MANAGEMENT MEASURES

The Company offers a safe workplace and competitive salaries and provides training for employees in specially designed programmes. In addition, the Company is improving personnel recruiting procedures and implementing measures that aim to reduce personnel turnover and encourage the self-development of personnel.

> For more, see the 'Human resource development' section

### 1.5 RISKS ASSOCIATED WITH OCCUPATIONAL AND INDUSTRIAL SAFETY

The Company is exposed to risks involving the safety of employees, equipment, buildings and structures. Numerous factors may have a negative effect on the Company's core activities, including the breakdown or failure of equipment, labour disputes, injury to personnel and third parties, natural disasters, political disputes or acts of terrorism. Any of the risk factors may have a significantly adversely impact on the business, financial condition and results of the Company's activities.

## RISK MANAGEMENT MEASURES

In order to mitigate these risks, the Company is implementing a large-scale integrated programme that aims to ensure safe working conditions for employees and safe manufacturing processes. This programme complies with the best international practices and is based on enhancing the role of production managers at all levels in ensuring work safety. The Company has successfully applied the experience gained from international oil companies by adapting it to the conditions of its production sites. In particular, the Company has introduced behavioural safety audits and internal incident investigations in order to identify and eliminate the causes, is implementing a transport safety programme, has introduced risk assessment for hazardous work and holds numerous drills, training exercises and seminars for all levels of the organisation. The Company has certified the work safety management system for compliance with the OHSAS 18001 international standard, adheres to the principle of continuous improvement and has selected priority areas of this system for the coming years. The Company has declared 2016 the Year of Occupational Safety.

> For more, see the '[Industrial and Environmental Safety, Occupational Health and Safety, Energy Efficiency and Energy Conservation](#)' section

## 1.6 ENVIRONMENTAL RISKS

The production activities of Gazprom Neft are fraught with the potential risk of an environmental impact that exceeds the permitted standards, which may result in civil liability and the need for work to eliminate such damage. The Company is fully aware of its social responsibility to create safe working conditions and maintain a favourable environment, continuously monitors its activities to ensure compliance with the relevant environmental standards and is implementing an environmental protection programme. In the future, costs associated with observing environmental requirements or obligations may increase.

## RISK MANAGEMENT MEASURES

The environmental protection policy of Gazprom Neft aims to ensure compliance with the requirements of current environmental legislation by investing substantial funds in environmental measures, including the use of technologies that ensure minimal negative impact on the environment. These activities have resulted in a significant decline in the probability of risks associated with environmental pollution. The Company also follows the changes in environmental legislation in the different countries in which it operates.

> For more, see the '[Mitigating negative environmental impacts and the effective use of resources](#)' section

## 2 MARKET RISKS

The main areas of Gazprom Neft's operations are oil and gas production, oil refining and the sale of oil and petroleum products, thus the Company is exposed to risks that are traditionally inherent to the oil and gas industry, namely:

- > risks associated with a possible change in prices for purchased raw materials and services;
- > risks associated with a possible change in oil and petroleum product prices;
- > risks associated with industry-wide competition;
- > risks caused by economic instability in the industry.

### 2.1 RISKS ASSOCIATED A POSSIBLE CHANGE IN PRICES FOR PURCHASED RAW MATERIALS AND SERVICES

In the process of its business operations, Gazprom Neft uses the infrastructure of monopoly service providers for the transportation of oil and petroleum products and the supply of electricity. The Company has no control over the infrastructure of these monopoly service providers and the amount of tariffs charged.

## RISK MANAGEMENT MEASURES

The Company is implementing a number of measures that aim to mitigate the impact of such risks:

- > long-term planning of commodity flows and the timely provisioning of the cumulative flow of oil and petroleum products as well as the necessary rolling stock;
- > the optimal redistribution of commodity flows by transportation type;
- > the use of alternative and internal sources of power generation;
- > long-term contracting with fixed volumes and prices for the entire duration of the contracts;
- > the use of transparent cost revision formulas as part of long-term service contracts that are strictly dependent on market fluctuations.

These measures make it possible to reduce risks associated with the use of services and the acquisition of goods from monopoly providers to an acceptable level and ensure the Company's continuity of operations.

> For more, see the '[Production and manufacturing expenses](#)' section