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Address of Supervisory Board Chair

Clare Spottiswoode  
Supervisory Board Chair

"The gas business will remain the most important and significant in the corporate portfolio. We expect that the development of new sites will quintuple the Group’s resource potential up to 600 bcm."

In 2020, the energy sector globally and, in particular, in Ukraine suffered greatly. The crisis has reduced domestic consumption and energy prices have fallen significantly, affecting Naftogaz’ profitability. Despite the foreseeable financial losses as a result of both the global energy market and the long-running coronavirus pandemic, the Naftogaz Group has proven its resilience to the crisis.

Last year, the Naftogaz Group paid more than UAH 140 billion to the state budget of Ukraine, entered the gas retail market and quickly expanded its presence there. The Group also provided significant charitable support to hospitals in fighting the pandemic.

Last year, the Government approved the new Naftogaz Charter and the Ownership Policy. Although the Charter is not fully compliant with the OECD Guidelines on Corporate Governance of State-Owned Enterprises yet, I believe it is one of our key achievements in the year.

With these documents, we intensified our work on the Naftogaz Group Corporate Strategy, which was approved in January 2021. This is an important document which charts Naftogaz’ vision and aims for the next few years.

The pandemic induced us to re-conceive the directions of our development, and to identify new challenges and opportunities.

Naftogaz is currently an oil and gas company. It is clear that with the climate change challenges we will have to set a different, greener course over the next few years. This means we will need to look at how we can help Ukraine to decarbonize its economy while ensuring our energy supplies remain secure. We will build on our strengths to ensure our contribution has maximum impact. Naftogaz is committed to achieving carbon neutrality by 2040. We are currently developing plans to ensure that we will achieve this goal. It requires action now.

For us, hydrogen energy and biogas production from agricultural waste are promising areas. Movement in this direction needs to be careful and well balanced, since the company should remain profitable while developing new areas. Understanding the importance of Naftogaz for the economy of Ukraine and the state budget, we cannot afford to invest in non-profit projects.

However, it must be understood that the effectiveness of the implementation of the approved Naftogaz Group Corporate Strategy largely depends on government policy. Last year has witnessed effective cooperation between Naftogaz and the Parliament, the Presidential Office, and the Government of Ukraine.

At the end of 2020, thanks to the fruitful cooperation of the Government and Naftogaz teams, the company received new promising licenses for Yuzivska area and the Black Sea offshore.

We have been waiting for a long time for the opportunity to go to new greenfield sites. We now have new licenses, which enables us to focus on the new opportunities, in particular – the offshore. This year, we are starting the development of the new areas. Our ultimate goal remains the same. We strive to produce more gas to ensure Ukraine’s energy independence. But we will only develop gas which gives us and the country a good return on our investment.

We have a new leadership team of professionals with experience in the world’s leading energy companies who are helping the company to achieve this goal. The approved Naftogaz Group Corporate Strategy stipulates that its future development will be based on three business platforms: gas business, supply to end users, and low carbon businesses.

We believe that with stable macroeconomic indicators and effective implementation of reforms in the country, the Naftogaz Group will be able to implement its strategy and become the largest investor in the country’s economy.

The financial result of the Group is our full responsibility, however, our profitability depends on many things, such as energy prices, which are not in our control. We have to manage the company so that we can survive whatever the circumstances. In doing this, we need the support and understanding of the Government.

For example, as a result of a decision of the Government, the company paid more than 90% of its profit to the budget as dividends for two years in a row. This inevitably means that the investment capabilities of Naftogaz were significantly limited. Without retained profits, we do not have cash to invest without raising external finance.

Unfortunately, Naftogaz had to postpone the issuance of Eurobonds due to the international capital market’s political concerns about Ukraine.

Recently, the international credit rating agency Fitch has affirmed Naftogaz at “B” with stable outlook, most likely because of positive changes in the company’s operating model and management system.

We know our objective and our mission; we know the tools required to achieve the goal. The management system of Naftogaz will be in line with world’s best practices to make sure the company is prepared for an IPO.

Our goal is to become the best gas supply partner for Ukrainian consumers by 2025, reaching a substantial market share in the retail market.

“Our goal is to become the best gas supply partner for Ukrainian consumers by 2025, reaching a substantial market share in the retail market.”
Our key achievement of 2020 was the constructive partnership achieved jointly with the shareholder and stakeholders. The ability to hear each other made it possible to resolve serious historical problems in the Ukrainian gas market. This gave new impetus to the continuation of reforms in the energy sector and Naftogaz corporate governance.

1. OPENING OF RETAIL GAS MARKET IN UKRAINE

The liberation of Ukrainians from long-term gas serfdom was the impetus for further reform of the energy sector. It is only now that consumers can freely choose their gas supplier and are actively exercising this right. By the end of the year, the number of customers who chose Naftogaz of Ukraine Gas Supply Company as their supplier exceeded 900,000, more than three times the total at the launch of the retail market in August 2020.

Freedom of choice of supplier and free pricing promote the emergence of new, independent actors and increase competition in the market.

However, the retail gas market is only now developing, its own rules of operation in Ukraine. I am pleased to note that Naftogaz’s proposals are not only accepted by its own customers, but also supported by the regulator.

For example, this was the case with our “Annual” tariff plan, which allows customers to fix the price of gas for a year without prepayment and avoid additional costs from possible price fluctuations during the course of the year. The regulator decided that from May 1, 2021, all suppliers, following the example of Naftogaz, should automatically offer their customers annual tariff plans.

We hope that further cooperation with the government and the regulator will be just as constructive as in 2020, for the comfort of Ukrainians. After all, customer satisfaction is the key indicator of market efficiency.

2. SETTLEMENT OF HISTORICAL DEBTS

Since 2015, Naftogaz has been performing public service obligations (PSO) in the natural gas market assigned to it by the government to ensure the public interest.

Although the relevant mechanism is provided for in the Law of Ukraine “On the Natural Gas Market”, the procedure for calculating and compensating Naftogaz for losses from such activities was not developed until 2020.

This problem was solved thanks to the joint efforts of the Parliament and the government. A mechanism was developed that allowed for payment of compensation to Naftogaz for losses from the performance of special duties from 2015 to 2019.

PSO compensation solved two more historical debt problems. The first was the debt of Naftogaz for gas delivered in 2006, and the second was Ukraine’s tax debt to the state. The funds paid as compensation to Naftogaz were not only returned to the state budget, but also resulted in UAH 10.3 billion in additional tax revenue.

3. APPROVAL OF NAFTOGAZ’S OWNERSHIP POLICY AND NEW CHARTER

Naftogaz was the first Ukrainian state-owned company to have an independent supervisory board. This was a significant step that paid off: the new supervisory board is a barrier to the political influence and allows company management to act in the interests of the company and its ultimate owner, the Ukrainian people.

In 2020, the Government of Ukraine approved the Ownership Policy and the updated Charter of the Company – two basic documents that define the purpose and objectives of the Company.

The main tasks of Naftogaz Group are related to energy security, both in terms of the country as a whole and each gas consumer. This means the protection of Ukrainian interests in the international arena, partnerships with the national oil and gas companies of other countries, and the fight against the construction of Nord Stream 2. Key Naftogaz Group focuses also include the supply of natural gas, both on a market basis, and through the «last resort» supplier mechanism.

The updated Charter significantly expanded the powers of the supervisory board. For the first time in many years, the supervisory board approved Naftogaz’s Strategy.

The new strategy provides for further development of the Group based on three business platforms: gas business, B2C, and low-carbon businesses. The strategy concentrates our transformation process in one vertically integrated company.

4. GETTING ACCESS TO NEW AREAS

In 2020, for the first time in many years, Naftogaz gained access to significant gas-bearing areas to increase Ukrainian gas production. The company now has the right to develop the Yuzivska area, it has signed four new production-sharing agreements and gained access to the Black Sea shelf.

The Yuzivska area was one of the first serious projects in Ukraine featuring the engagement of major international Naftogaz of Ukraine Gas Supply Company. Unfortunately, the Russian attack hindered implementation of the project. However, the state and Naftogaz see the Yuzivska area as highly prospective. Full-scale development requires tens of billions of hryvnias, making it one of the largest investment projects in eastern Ukraine.

We have signed four production-sharing agreements with the government to develop four oil and gas fields: Balakliska, Yuzivska, Buzhivska and Bereishtska. The expected investment in the first five years is UAH 3.6 billion.

Development of the Black Sea shelf is one of the most promising areas of activity for both the country and for Naftogaz. Our commitment and readiness to begin this ambitious project is a signal to the world that Ukraine is capable of implementing large investment projects.

5. NAFTOGAZ GROUP RETAINS STATUS AS LARGEST SOURCE OF STATE BUDGET REVENUES

Support to the state and the state budget is one of the main tasks of Naftogaz. In 2020, we paid a record amount of taxes and dividends: over UAH 140 billion.

Naftogaz also contributed significantly to countering the COVID-19 pandemic. The company spent over UAH 700 million to purchase medical and protective equipment for healthcare providers.

Almost 300 healthcare institutions in 24 Ukrainian regions received protective suits, masks, medical equipment, oxygen cylinders, and more. Naftogaz provided protective equipment to students and teachers during external independent testing in 2020.

From the first days of the pandemic, Naftogaz Group facilities and enterprises have implemented enhanced safety protocols, which have minimised infection rates among employees.

OUR TAKEAWAYS FROM 2020 INTO 2021

In 2020, we moved closer to fulfilling our strategic corporate goal. We strive to become a partner of the Ukrainian government in achieving national energy independence through the development of our national resource base, optimization of consumption, and development of energy markets.

The government has significantly expanded the powers and capabilities of the Naftogaz supervisory board to oversee the activities of management. According to OECD standards, the supervisory board has the right to approve strategy, and this right was realized in 2020.

However, approval of the financial plan for Naftogaz and its subsidiaries is still beyond the powers of the supervisory board, leading to delays in capital investment. This and a number of similar discrepancies with international corporate governance standards should be eliminated in order to effectively prepare Naftogaz for IPO to fulfill the government’s expectations from Naftogaz.

We are convinced that the victories of Naftogaz are victories for Ukraine and all Ukrainians. Improving the economic condition of Naftogaz is only possible in parallel with Ukraine’s broader economic growth.

I am grateful to my colleagues in Naftogaz Group for the successes we have achieved in 2020, for the historical Gordion knots we have cut, for the new projects we have launched. I am confident that whatever difficulties we may face, we are well-groomed for moving forward.
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**Naftogaz Group**

**Annual report 2020**

**Responsibility**
- Corporate Social Responsibility
- Independence
- Efficiency
- Security of Supply
- Operational Efficiency
- Gas Market Reform
- Gas Independence

**Naftogaz CEO advisor to appointed an Olena Zerkal was CFO Naftogaz Group Pertrus Van Driel transformation Naftogaz Group’s Otto Waterlander executive board the composition board changed The supervisory TSO unbundling 2020 2021 Exchange Ukrainian Energy to buy gas on the Naftogaz started Development and Sustainable Industrial Ecology the EBA Naftogaz joined Russia in Crimea from the Groups damages arising evaluation of Nearly $8 bn the past 30 years

**Kobolyev for 4 years contract with A. extended the The government outlook Naftogaz’s B rating pilot project within the WeEnergy for electric vehicles Naftogaz installed its depleted fields production at increase gas Petroleum to engaged Expert Naftogaz Group engendered Expert Petroleum to increase gas production at depleted fields Naftogaz installed its first charging stations for electric vehicles within the Medvedych project program both confirmed Naftogaz’s 4 ringing with positive outlook The government extended the contract with A. Nadra for 4 years

**Gas Independence**
- Nearly 5 bln, the evaluation of damages arising from the Groups assets owned by Russia & China

**Corporate Social Responsibility**
- Financial overview
- How we work
- Transformation: how we work
- Strategy: how our business operates
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- Financial overview and statements
“The world will never be the same.” Due to the COVID-19 pandemic, these words have become the unofficial slogan of 2020. The coronavirus crisis forced us to live under the new rules — with social distancing, antiseptics and masks, often in isolation.

Naftogaz Group was no exception and we also had to face new challenges. The pandemic reminded us that human life is the main priority. Protecting the health and lives of our employees has become our key objective.

Of course, other important challenges emerged as well. We had to:

— Maintain the continuity of operations. The Group includes a number of businesses that make up one system, on which the economy of the whole country directly depends. We reviewed our production and management processes and adapted them to the pandemic context.

— Learn to work remotely. We had to transfer all work and business processes to remote in an emergency mode. This was done without any previous experience or any time for ramp-up, but we managed to cope quite successfully.

— Perform the role of a «corporate citizen». Naftogaz Group is a key player in the Ukrainian economy and one of the largest taxpayers in the country. Through our corporate social responsibility programs, we are committed to help the country overcome the pandemic and save people’s lives.

The transformation that started in Naftogaz Group shortly before the COVID-19 pandemic was a factor that helped us adapt to life in this new reality. Updated operational model and reviewed business processes, focus on digitalization, and reduction of bureaucratic steps are the fundamental principles of our transformation plans. It is thanks to the steps already taken in these areas that we have been able to quickly build up the right interaction channels within the company amid quarantine.

The COVID-19 pandemic has had a major impact on the global economy. This applies not only to petroleum products and natural gas. Almost every sector of the global economy has experienced a decline in demand for its products and services. At the same time, the lessons learned in 2020 proved the correctness of Naftogaz Group’s chosen strategy. We are well on the way of transforming an extracting company into a national energy service operator by developing new businesses, in particular, retail and green energy, we increase our resilience to potential future crises. In such a way, we create new sources of income, which is the key to the financial stability of Naftogaz Group, even in the event of a fall in world energy prices as observed in 2020.

For the ongoing transformation of Naftogaz Group, COVID-19 has become an additional factor that accelerated the changes taking place in the company and made them more effective. We had no other choice. Naftogaz Group employs more than 51,000 people across Ukraine and they have been retained during this critical time. The situation with coronavirus and the need to shift to remote work prompted us to transform the Group even faster than we initially planned. And we succeeded.

Of course, we could not remain indifferent to the challenges faced by the nation and took effective measures to help people.

Task #1 was to save as many lives as possible, to help hospitals and doctors who were at the forefront in the fight against the pandemic.

Our approach here from the very beginning of the pandemic was not selective and covered not only the employees of Naftogaz Group or the regions of our business presence. As a socially responsible national company, we aimed to provide assistance throughout Ukraine.

Together with the Ministry of Health, we identified the key priorities and a list of products hospitals needed most. The list included medical equipment required to diagnose and treat patients with the coronavirus: X-rays, ultrasound devices, patient monitors. Doctors and nurses also experienced a terrible shortage of personal protective equipment, namely protective suits and medical masks.

With the support of our partners in China, Naftogaz Group purchased more than 200 tons of medical cargo in record time and delivered it to Ukraine on three flights, including one with the world’s largest aircraft, the An-225 Mriya. This was a landmark project of 2020. The humanitarian cargo included 500,000 protective suits, 700 patient monitors, 50 mobile digital X-ray machines, and 50 portable ultrasound devices.

The company distributed all this equipment as charitable assistance to 287 medical institutions in all regions of Ukraine. The total cost of the cargo and transportation amounted to UAH 589 million.

Additionally, in order to facilitate the safe external independent testing of schoolchildren, Naftogaz Group responded to a request from the Ministry of Health of Ukraine and purchased medical masks, contactless thermometers, disinfectants, insulated medical gowns, and medical protective suits to assist 287 medical institutions in all regions of Ukraine. In total, since the introduction of quarantine in Ukraine, the Group has allocated more than UAH 589 million.

Additionally, the Government of Ukraine and purchased medical masks, contactless thermometers, disinfectants, insulated medical gowns, and medical protective suits to assist 287 medical institutions in all regions of Ukraine.

US $1.5 million.

UAH 36 million was allocated to purchase the necessary medical equipment in the areas that the government identified as key priorities and a list of products hospitals needed most. Ukraine purchased 4.2 million to repair 49 lung ventilators.

In total, since the introduction of quarantine in Ukraine in March 2020, Naftogaz Group has invested more than UAH 700 million in charitable assistance to support hospitals and healthcare institutions.

Helping the country remains our priority. At the beginning of 2021, 10,000 fifty-liter oxygen tanks for lung ventilators, worth a total of about UAH 50 million, were transferred to healthcare institutions across the country.

In 2020, Naftogaz Group received a collective award in the category “Business that changes the country” from CSR Ukraine for our case “Caring about protection”. Indeed, we have successful experience to share with other companies.

Naftogaz Group was one of the first of the country to introduce remote work to minimize the risk of infection for employees. The IT infrastructure of the head office and our companies has successfully passed this stress test. Within a couple of weeks, remote work had become almost routine. From the beginning of the pandemic until today, we followed the basic rule: all employees whose presence in the workplace is not critically necessary must work remotely.

At the same time, we realized that our companies play a strategic role for the entire Ukrainian economy and are critical elements of Ukraine’s infrastructure. For technological reasons, workers engaged in production processes continue working on site. We had to maintain the continuity of production processes, and at the same time, we had to prevent the spread of infection within the team. Therefore, in a short time since the beginning of the pandemic, all Group companies have been provided with medical PPE and disinfectants, mass events have been canceled, temperature measurement and control at the entrance to all facilities have been introduced, a health monitoring system has been launched, and clear rules of action identified. In some cases, we even changed work schedules. For example, we extended the duration of shifts at gas production sites.

The Group has introduced systematic support for employees who are ill — from daily monitoring of the patient’s condition to arranging medical care if necessary. Indeed, we were not able to protect all our employees from the virus. However, mortality due to COVID-19 among Naftogaz employees is lower than the average in Ukraine.

The results of the first year of work in a pandemic show that quarantine has changed not only our business processes, but also our value system, reminding us that human life and health are the main priorities. At the same time, we have become more flexible, stress resilient, and result-oriented. I am sure that after the quarantine, we will keep the most valuable thing that the crisis has taught us. We are well aware that any crisis is not only a limitation, but also a new opportunity.

In 2020, we used the opportunities provided by the crisis to initiate new projects and develop new business areas. First and foremost, those transformations are part of the Naftogaz Group’s strategy. However, the crisis has become a powerful catalyst for change.

The launch of a retail gas market from August 1, 2020 and household spending optimization as a result of the economic crisis brought the rapid growth of the Naftogaz Group retail business. We have developed one of the most advantageous offers on the market for consumers. As a result, the number of households that chose Naftogaz as their gas supplier has increased 2.5 times in five months.

In 2020, the operations of the Ukrainian gas storage opened up a new breakthrough in the gas market. For the first time in history, 10 billion cubic meters of gas, or every third cubic meter in the Ukrainian gas storage facilities, was owned by foreign customers from 24 countries. This situation was due to the fall in gas consumption and drop in energy prices. European traders were looking for facilities to store surplus gas in anticipation of seasonal price rises. And Ukraine’s gas storage facilities provided this opportunity to foreign customers.

Naftogaz Group responded to the global shift to safe and affordable energy sources with the development of alternative energy projects. We started solar power plant construction and the development of the electric vehicle charging network.

Serhiy Peneloma
First Deputy CEO

“Through our corporate social responsibility programs, we are committed to help the country overcome the pandemic and save people’s lives.”

Address of First Deputy CEO
Naftogaz’s response to Covid-19

Naftogaz Group remains a reliable partner of the Government and communities where it operates to respond to the COVID-19 challenges.

UAH 700 million Naftogaz Group’s contribution to COVID-19 relief since the introduction of quarantine in Ukraine.
Macroeconomic overview

IMPACT OF LARGE-SCALE LOCKDOWN AND FURTHER RECOVERY OF UKRAINE’S ECONOMY

In 2020, Ukraine’s economy was heavily affected by the COVID-19 outbreak. However, the impact of the pandemic was less severe than originally anticipated, as the full-scale lockdown only lasted from mid-March to early May and was replaced with adaptive quarantine, which allowed most services to resume and revived business.

Ukraine’s GDP in 2020, according to the State Statistics Service, decreased by 4.4% compared to 2019. According to the World Bank forecast from January 2021, GDP growth in 2021 will reach 5.0%, which indicates a rapid recovery.

Weak external demand has significantly affected the main export-oriented industries: mining, metallurgy and industrial sectors, as evidenced by the industrial production index equal to -4.5% in 2020.

Real wages stabilized after the lockdown. Initially, the level was lower than in 2019; however, it showed a moderate increase to 7.4% during the year 2020. This fact and maintaining the volume of private remittances from abroad restored domestic demand for goods and services in Q3 and Q4 of 2020.

The consumer price index’s growth rate was moderate and below the NBU target range in the first half of 2020. The inflation was restored primarily due to cheaper energy (oil, natural gas) on the world market, maintaining the effect of strengthening the national currency in the pre-quarantine period and high prices for export commodities (grain, ore, steel), which contributed to the inflow of foreign currency.

The increase in consumer prices accelerated due to the recovery of the Ukrainian and world economies after the lockdown in the second half of 2020. The consumer price index in 2020 was 2.7%. In December, core inflation reached the NBU target (5% + -1 percentage points).

The NBU, in order to support the Ukrainian economy during quarantine and to balance investments and savings, opted for easing monetary policy primarily by lowering the key policy rate. In early 2020, the rate was 11%, while in Q3 of 2020, it reached a surge of 15% growth compared to the same period in 2019 due to the active placement of government securities, cooperation with international creditors, and a current account surplus.

In February 2021, the RfP refused to provide a second tranche, in part due to the return of a temporary gas price regulation.

According to the NBU forecasts, in 2021-2023, Ukraine will experience a current account deficit, which will be caused by the growth of external demand, the resumption of investment activity, and a decrease in gas transit.

The response of the market to the uncertainty caused by the COVID-19 pandemic was an increase in the yield on government bonds in the national currency in March-May 2020, although demand for bonds remained low. The accelerated recovery of the economy after large-scale lockdown helped investor interest in government securities. By the end of 2020, domestic and foreign investor demand for Ukrainian domestic government bonds resumed.

The easing of monetary policy and the resumption of demand for hryvnia-denominated government bonds after the large-scale lockdown led to a decline in the yields of bonds to pre-crisis levels by the end of the Q2 of 2020. However, in Q4 of 2020, bonds demonstrated an increase in yield as a result of record placement of government securities. By the end of 2020, the Ukrainian government issued Eurobonds – 7.25% maturing in 2033. This was possible because of the soft monetary policy and a drop in the risk premium for developing countries.

The introduction of quarantine restrictions resulted in a surge in the unemployment rate in Q2 of 2020. The reason for the surge in the unemployment rate in Q2 of 2020 was the drop in the risk premium.
this was not only the loss of work due to the pandemic, but also the simplification of the procedure for acquiring the status of an unemployed person. After Ukraine eased lockdown in May 2020, demand for labor resumed.

The volume of private remittances to Ukraine in 2020 remained at the level of 2019 [about USD 11.9 billion]. This is explained by the unchanged demand for labor in countries with a Ukrainian presence in their workforce.

Despite quarantine measures and the crisis situation in Ukraine, the volume of gross international reserves continued growing and reached UAH 251.6 billion as of the end of 2020, an increase of 15% compared to the same period in 2019. This is caused by active placement of government securities, cooperation with international creditors, and a current account surplus.

In 2020, net outflows of foreign direct investment amounted to USD 950 million. According to the NBU forecast, inflows of foreign direct investment will resume in 2021–2023 due to inflows of capital and an increase in reinvested earnings.

According to preliminary estimates as of the end of 2020, public debt amounted to 60.2% of the GDP, 69% of debt represents borrowings at a fixed interest rate, which offsets the impact of changes in interest rates. However, 34% of the debt is denominated in US dollars, which creates currency risks.

Significant repayments of public debt are due in 2021 – UAH 597 billion. 24% of the amount is the domestic and external debt servicing.

Ukraine's economy recovered faster than expected at the beginning of the crisis caused by the COVID-19 pandemic, due to accelerated recovery in the second half of 2020. Ukraine is forecast to overcome the negative effects of the pandemic in 2021 and return to pre-crisis GDP growth rates + 3% and + 4.2% according to the World Bank and the NBU, respectively.

Growth will be driven by external demand as a result of an increase in real incomes and pickup in the investment activity of businesses. With rising energy prices [natural gas for households and gas-dependent housing and utilities, automotive fuel, growing food supply (higher than last year’s crop yields)], and growing consumer demand, inflation is expected to rise above the target range in the first half of 2021. A rise in economic activity and rising energy prices will lead to an increase in the energy component of imports. Ukraine looks forward to further cooperation with the IMF, namely a new standby program that is expected to fund a significant portion of its budget expenditures. Ukraine's cooperation with the IMF is important for obtaining funding from the EU, the World Bank, and other international financial institutions.

THE IMPACT OF THE GLOBAL PANDEMIC AND FORECAST FOR THE WORLD ECONOMY

The COVID-19 pandemic has caused a global recession, the deepest in the last 150 years after the two World Wars and the Great Depression, according to the World Bank. The IMF and World Bank estimate the world economy decline in 2020 at 3.5% and 4.3%, respectively. However, the IMF forecast as of April 2020 predicted a drop in the world GDP by 3.0%, and yet in January 2020, growth by 3.3% was expected.

The pandemic has significantly impacted the development and operations of many sectors of the economy and generated new trends in world markets.

- The world’s largest economy, the United States, shrank by 3.4% in 2020, at a slower pace than expected, mainly due to an increase in manufacturing in Q4 of 2020. The United States has suffered the most from the pandemic in terms of number of patients and deaths. Domestic and social factors also significantly affected the economic situation.

- China is almost the only economy in 2020 to show GDP growth (2.3%). China is now playing an important role in restoring world trade: strong demand from China which has reaped back to pre-coronavirus growth rates, has supported increases in energy and commodity prices.

- According to a McKinsey study, energy demand fell by 7% in 2020 due to declining economic activity. The International Energy Agency (IEA) expects that under the baseline development scenario, energy demand will return to pre-pandemic levels in 2022. Uncertainty over the duration of the pandemic and tight quarantine measures has caused a global shock to both supply and demand in capital markets. In 2020, the world saw a decrease in foreign direct investment in countries by 43% compared to the same period in 2019. The smallest decline in foreign direct investment inflows in 2020 was observed in developing countries (-12%), while developed countries experienced (-69%). Successful vaccine testing and the completion of the US election have restored investor interest in capital markets. The recovery of the world economy exceeds expectations. However, the current pace of progress is threatened by the deteriorating epidemiological situation around the world. At least three new strains of the virus have been identified since the beginning of the pandemic. Many European countries have introduced new quarantine restrictions since the beginning of 2021. Further economic development will be determined by the success of the fight against the virus, including vaccination programs.
**Natural gas market**

2020 was challenging both for Ukraine and the global community. The COVID-19 pandemic resulted in reduced production, cut consumer spending, and led to a slowdown in the global economy. The past year could be clearly characterized as a year of pandemic disease and lockdowns, a year of unprecedented events, and the decline of energy markets.

**GLOBAL GAS MARKET**

The COVID-19 pandemic became an issue in January 2020 and acquired a global character, which led to decreased activity in the industrial sector. There is a high correlation between number of COVID-19 cases and the Industrial Production Index (IPI). For instance, during the lockdown in March-April 2020, Italy’s IPI fell up to -43.3, while at the beginning of 2020 it was around 0. IPI in Germany decreased from -3.2 in January to -29 in April 2020. In the US, IPI also demonstrated reduction from -0.8 to -15 during the same period. Ukraine did not differ much from other countries. IPI decreased in Ukraine from -5.1 in January to -16.2 in April 2020. This had a negative influence on Ukrainian GDP, which dropped by 17% in the first quarter 2020.

With the slowdown of COVID-19 starting from June 2020, industrial production started to recover. Germany (IPI partially recovered to -13.3), while in the US the figure reached -10.8. The recovery of IPI in Ukraine was also observed, which almost returned to the level of early 2020. Meanwhile, in the epidemiological situation worsened, and the number of new COVID-19 cases grew progressively, meaning IPI recovery also slowed down. However, lockdown in China has been fulfilled by the end of the spring 2020, and starting from the second quarter 2020, the country’s economy began recovering, showing a positive IPI.

Global gas production fell by 3.6% (to 146 bcm), compared to 2019. A crisis in the oil industry, specifically in the first half 2020, was observed all over the world. Most global companies revised plans for capital investments downwards by 40-60% due to the uncertainty on the market related to low prices and uncertain demand. For example, Chevron cut its capital investments by 43% to USD 14 billion. In general, according to the IEA (International Energy Agency), global capital investments of oil companies decreased by 35% compared to the previous year to produce the lowest total for the last 13 years. It should be noted that a majority of companies that are not in the global TOP 10 have gone through bankruptcy, layoffs, and business closures in 2020. This situation created conditions for the merger of small businesses with larger companies: Chevron and Noble Energy, Devon Energy and WPX.

As a result of the fall of industrial production during the pandemic lockdown, there was a significant decrease in demand for energy resources: global natural gas demand dropped by 2.5% (about 100 bcm), while in Europe the drop was 3.5%. This fall in demand in Europe also reflected the high level of gas in European storage at the end of the 2020 heating season (a record high for the observed period), which had a negative impact on price movements in the first half of 2020.

EU gas consumption in the second quarter of 2020 decreased by 10% in year-on-year comparison, after going down by 4% in the previous quarter, according to the European Commission data. Such a huge year-on-year decrease in Q2 2020 could not be observed.
over the last six years, owing to the broad impact of confinement measures relating to the Covid-19 pandemic, which could be tracked in gas demand for industry and electricity generation. In Spain and Italy gas consumption in Q2 2020 fell year-on-year respectively by 20% and 21% (in volumes; -2.7 bcm and -1.7 bcm). In Great Britain and France after insignificant growth in March, natural gas consumption dropped drastically in April to -38% and -35% y-o-y.  

In this respect, prices in the first half of 2020 tended to decrease sharply. Spot prices on the TTF hub in May reached an historic minimum – 4.5 Euro/MWh, which is almost 50% less than in January 2020, or 66% less that the same period of 2019. Despite the fact that prices at the end of the third quarter of 2020 had started to recover gradually to reach a maximum value of 16.3 Euro/MWh in December 2020 (TTF hub), this did not help to resolve the situation with the losses that were caused by a drastic price drop in the first half of 2020. Gas prices in Europe during 2020 decreased on average by 30% (from 13.5 Euro/MWh in 2019 to 9.46 Euro/MWh in 2020). Prices on the other two main gas hubs also demonstrated significant decreases compared to average prices in 2019: in the USA (Henry Hub) – by 28% (from 2.56 USD per MMbtu in 2019 to 2.00 USD per MMbtu in 2020), in Asia (JKM) – by 25% (from 5.61 USD per MMbtu in 2019 to 4.24 USD per MMbtu in 2020).  

In line with demand and price decreases, LNG supply has also suffered and experienced one of the greatest falls. In 2019, LNG imports almost doubled compared to 2018. For the first time, EU countries bought more than 100 bcm of gas. 2020 started with the usual growth rates in January (33%) and February (36%). With more restrictive measures, the growth rate significantly decreased. Starting from June, a sharp decline began, which only increased by the end of the year. In December 2020, LNG imports decreased by 43% on a year-to-year basis. In absolute values, imports reached a new low not only for 2020, but also for the last three years from September 2018. The LNG market reacted to the coronavirus lockdown with great delay when demand started to recover in Asia. As a result, available LNG volumes shifted to the East in order to return the “premium” lost in 2020. At the beginning of 2021, the “Asian premium” (the ratio of the Asian spot index JKM to European spot prices) was more than 50%. The rise of LNG prices in the Asian region, as well as increased demand due to abnormally cold weather in Europe, (from 13.5 Euro/MWh in 2019 to 9.46 Euro/MWh in 2020). The rise of LNG prices in the Asian region, as well as increased demand due to abnormally cold weather in Europe, (from 13.5 Euro/MWh in 2019 to 9.46 Euro/MWh in 2020). The rise of LNG prices in the Asian region, as well as increased demand due to abnormally cold weather in Europe, (from 13.5 Euro/MWh in 2019 to 9.46 Euro/MWh in 2020). The rise of LNG prices in the Asian region, as well as increased demand due to abnormally cold weather in Europe, (from 13.5 Euro/MWh in 2019 to 9.46 Euro/MWh in 2020). The rise of LNG prices in the Asian region, as well as increased demand due to abnormally cold weather in Europe, (from 13.5 Euro/MWh in 2019 to 9.46 Euro/MWh in 2020). The rise of LNG prices in the Asian region, as well as increased demand due to abnormally cold weather in Europe, (from 13.5 Euro/MWh in 2019 to 9.46 Euro/MWh in 2020).
ABnormally warm year

According to the National Oceanic and Atmospheric Administration, 2020 was the second warmest year in the 141-year record, with a global land and ocean surface temperature deviation from average of +0.98°C. The seven warmest years in the 1880–2020 period since records began have all occurred since 2014, while the 10 warmest years have occurred since 2006, 2020 marks the 44th consecutive year (since 1977) with global land and ocean temperatures, at least nominally, above the 20th century average. The year 2020 was characterized by warmer-than-average temperatures across much of the globe. Record high annual temperatures over land and ocean were measured across parts of Europe, Asia, the southern part of North America, South America, and across parts of the Atlantic, Indian, and Pacific oceans. However, no land or ocean areas were recorded to be cooler last year.

Europe had its warmest year over the observation period with 2.18°C above average, surpassing the previous record set in 2018 by 0.28°C. This was also the first year where Europe’s annual temperature deviation was over +2.0°C. Europe’s annual temperature has increased at an average rate of 0.15°C per decade since 1900; however, this has more than tripled to 0.47°C since 1981.

February 2021, on the other hand, was characterized by colder-than-average temperatures across much of North America and northern Asia, where temperatures were at least 3.0°C below average. Other areas with below-average temperatures included much of the eastern and central tropical Pacific Ocean, Australia, southern Africa, southern South America, and parts of the southern oceans. North America had its coldest February since 1994 and the 20th coldest February in the regional 112-year observation. The air temperature anomaly observed during last year creates the conditions for natural gas price volatility, along with a deterioration in gas market forecast quality.

In Ukraine, the average 2020 annual temperature exceeded 11°C for the first time and amounted to 11.1°C, which is 0.22°C higher than the average 2019 annual temperature and 1.11°C higher than the average 2018 annual temperature. For the first time on record, the average monthly temperature in January and December did not fall below 0°C. Abnormally warm weather in Q1 2020 was a factor of reducing natural gas consumption by households by almost 650 mcm (-15.4%) according to the National Commission for State Regulation of Energy and Public Utilities. DHCs also reduced their natural gas consumption in Q1 (by 250 mcm, or 6%). Due to abnormally low air temperatures in April-May, households increased natural gas consumption by 240 mcm (±2%) compared to 2019. This weather volatility creates preconditions for the unpredictability of gas consumption in Ukraine.

Natural gas production

In 2020, global natural gas production decreased by 144 bcm (-3.6%), to 3,845 bcm as low oil and gas prices led to lower exploration and production. With production estimated to have dropped by 47 bcm to 1,103 bcm in 2020, North America was the gas-producing region most impacted by the COVID-19 pandemic. It should be noted that before that, global gas production was growing exceptionally. 2020 marked the first year in a long time when even the fast-growing Asian region could not resist the global pandemic and the era of low prices in the natural gas market.

EU natural gas production continued its downward trend, falling by 13.2% in 2020 compared with 2019, to total 96.2 bcm. Norway produced 116.2 bcm, which is also lower by 2.8 bcm (2.4%) than the previous year’s figure. The largest decrease in natural gas production in 2020 was observed in the Netherlands, where production decreased by 9.2 bcm (27.2%). In 2020, Poland produced more natural gas than Germany for the first time, becoming the 8th country by production volume in Europe (5.6 bcm in 2020). In 2020, total gas production in Ukraine was 20.2 bcm, which is 0.5 bcm (2.4%) less than a year earlier. Gross production of Utkhazaybovyanay, a key gas production company of the Naftogaz Group and the biggest gas producer in Ukraine, amounted to 14.2 bcm (a decrease of 4.7% compared to 2019). In 2020, Utkhazaybovyanay produced 13.45 bcm of commercial gas, which is 2% more than the production plan and 1% less than in 2019. Under the conditions of quarantine restrictions, reduction of the average annual gas prices by 30%, and reduction of investments by 50%, the company minimized the rate of production decline. Ukhtamta produced 1.13 bcm of natural gas.
in 2020, which is 3.0% (or 33 bcm) less than in 2019. On the other hand, private gas producers continued to increase gas output, reaching the level of 4.8 bcm in 2020, which is 5% higher than in 2019, thereby strengthening their position in the Ukrainian gas market.

In 2020, there were seven private gas production companies that produced more than 0.1 bcm of gas. Four of them – Zahidnadservice, Naftogazvydobuvannya, Smart Energy, and Burisma – increased gas production in 2020 compared to 2019. The rest – Ukraftobuvannya, Geo-Alliance, and PFC/UKR – decreased production in 2020. Naftogazvydobuvannya (ODEK Naftogaz) remains the largest private gas production company in Ukraine with 1.8 bcm annual production (11.3% growth in 2020).

**NATURAL GAS IMPORTS**

Due to the warm weather in 2020, natural gas consumption in Europe was 3.1% lower than in 2019. As a result, net imports of natural gas decreased by 33 bcm (48%) compared to 2019 and constituted 381 bcm. The largest declines in imports in absolute terms were seen in Germany (-11.7 bcm), France (-6.8 bcm) and Austria (-4.9 bcm). Compared to 2019, total gas imports increased by 11.3%, with a physical flow share of 54% compared to 2019 due to the availability of virtual reverse alternatives. Total physical import flows to Ukraine in 2020 constituted 8.5 bcm of natural gas, while virtual reverse amounted to 7.3 bcm.

Virtual reverse flows from Poland have become available through the Drodzowicki gas metering station since the middle of January 2020. In 2020, 1.0 bcm of natural gas as a virtual reverse flow was imported via the Polish route. Virtual reverse flows from the Slovak Republic (through the connection point Velke Kapusany – Uzhhorod) and Hungary (through the single virtual interconnection point “Bereg” [a merger of IP Beregoevo and IP Beregdaroc]) were launched on 1 March 2020 and 1 May 2020 respectively. Up to the end of 2020, Ukraine imported 3.2 bcm of natural gas from Hungary and 3.1 bcm from Slovakia via virtual reverse flow.

During 2020, Ukraine’s main gas supply route (including virtual reverse supply) was through the Slovak Republic. During 2020, deliveries through the Slovak Republic, Hungary, and Poland amounted to 66%, 26%, and 9% in total imports respectively compared to 64%, 26%, and 10% in 2019.

From January 1, 2020, the TSO of Ukraine introduced a short-haul service, which allows the company’s customers to order gas transmission between Eastern European countries through Ukraine at a favorable tariff rate. Together with customs warehouse service by Ukrtransgaz, foreign and domestic clients are offered convenient and attractive conditions of gas storage in the Ukrainian UGS. As of 1 January 2021, foreign traders stored 7.7 bcm of natural gas in the customs warehouse mode. This is 3.8 times more than in the same period a year earlier. 4.7 bcm of this gas was accumulated in short-haul mode. Residents kept 0.9 bcm of natural gas in the customs warehouse, including 0.5 bcm of gas transferred to the UGS in short-haul mode. Since November 2020, withdrawals of gas from the customs warehouse started with its direct delivery to the EU. A total of 82 traders ordered gas transmission services from the EU to Ukraine in 2020, including 52 Ukrainian companies and 30 foreign companies. Short-haul and “customs warehouse” services were used by more than fifty companies, most of which were non-residents.

**GAS TRANSIT**

Under the contract with Gazprom signed at the end of 2019, in 2020 the transit volume was set at 65 bcm before declining in 2021-24 to 40 bcm, which is associated with the construction of Russian gas pipeline Nord Stream 2. Nord Stream 1 deprived Ukraine of 55 bcm of gas per year, and the first phase of "Turkish Stream" led to the loss of 15 bcm in transit volumes to Turkey, Bulgaria, and Greece. At the beginning of 2021, Turkish Stream 2 was launched, planned to continue through Bulgaria and Serbia to Hungary. This means potential transit losses of up to 15 bcm - volumes that previously went to Hungary, Serbia, and Croatia. It should be noted that gas pipelines bypassing Ukraine do not contribute to the diversification of the European gas market, but rather increase dependence on Russian gas.

In 2020, the TSO of Ukraine transmitted 55.8 bcm of natural gas to Europe (-37.7% compared to 2019). The key factors in reducing transit to Europe were the launch of new gas pipelines bypassing Ukraine, as well as lower demand for natural gas in the EU and significant gas stocks in European UGS facilities. The transit agreement with Gazprom provides for 65 bcm of booked capacity (178 mcm per day) in 2020 and 40 bcm/y capacity (110 mcm per day) in 2021-2024. In 2020, transit volume was 9.2 bcm (-14%) less than provided by the agreement. At the same time, Gazprom has fully paid for the entire booked capacity under the contract, which includes a “ship-or-pay” provision. The average daily volume of transit since the beginning of 2020 amounted to 153 bcm per day, increased in December to 183 mcm per day as soon as additional capacity for gas transmission to European countries was booked through auction platforms. 51.9 bcm (-32%) was transited in the western direction: 38.5 bcm to Slovakia, 3.8 bcm to Poland, and 9.6 bcm to Hungary. In the southern direction, transit amounted to 3.9 bcm (-79%) to Moldova and 0.9 bcm to Romania.

**EU gas import**

-8% Ukraine’s gas import

+10% Naftogaz share in total import

**Distribution of gas imports to Ukraine by entry points in 2016 – 2020, bcm**

-38% Total gas transit through Ukraine

55.8 bcm of total Russian transit to Europe was through Ukraine

32%
REPORT UNDERGROUND GAS STORAGE WITHDRAWALS

Europe entered 2020 with record UGS stocks. As of 1 January 2020, storage facilities were 89% full (around 92 bcm) compared to 70% (around 72 bcm) on 1 January 2019. In 2020, European UGS volumes decreased by 14.1 bcm due to higher withdrawal rates and lower injection rates. The main factor in the reduction of gas volumes in UGS facilities was a decrease in imports, production, and consumption of natural gas.  

Ukraine’s gas storage facilities are the largest in Europe—more than 30 bcm of active capacity (28.8% of Europe’s total). In 2020, Ukraine’s UGS facilities reached historical maximum capacity. On 28 October 2020, Ukraine’s UGS facilities contained 28.4 bcm (91.9% capacity).  

Overall, Ukraine has a system of 12 UGS facilities with a total capacity of 31.95 bcm, of which JSC Ukrtransgaz (Ukrainian SSO) currently operates 11 UGS with 30.95 bcm of total active gas volume (excl. Glibivske UGS with 1 bcm capacity, which is located in the Autonomous Republic of Crimea). Since March 2015, the Verhunske UGS has been located on temporarily uncontrolled territory. Underground gas storage facilities are multi-purposed, but their main tasks are facilitating reliable uninterrupted and rational supply of natural gas to consumers, ensuring reliable gas transit through Ukraine to European countries, and creating long-term gas reserves in case of emergencies. The company provides gas storage services to both gas suppliers and consumers.  

The total capacity of exit points from UGS facilities to the gas transmission system (withdrawal) is 257.1 mcm per day (excl. the Verhunske UGS and Crimean capacities, which are located on temporarily uncontrolled territories), and the capacity of entry points (injection) is 246.1 mcm per day.

NATURAL GAS CONSUMPTION

Global gas demand fell by an estimated 2.5% (100 bcm) in 2020, the largest drop on record according to the International Energy Agency. Amid this slowdown, gas demand for power generation remained resilient owing to fuel changes, while the whole supply chain showed strong flexibility in adjusting to demand fluctuations. Gas trade globalization progressed with increasing liquidity, while prices experienced historical lows and extreme volatility. The COVID-19 crisis and a well-supplied market put investment on hold, whereas gas market reforms and clean gas policy initiatives gained momentum in major consuming markets.  

In Europe, gas consumption fell by 16 bcm (3.3% y-o-y), mainly due to the warm 2019-20 winter season and spring lockdowns that reduced all business processes in Europe and industrial production significantly. The second quarter showed the sharpest drop in gas consumption (by 11.8% compared to Q2, 2019). The largest reduction in gas consumption was in Western Europe (where the toughest and most prolonged lockdowns were observed), while some Eastern European countries (where lockdowns were temporary and short-term) increased consumption.  

Natural gas consumption in Ukraine increased by 3.7% in 2020 compared to 2019 (from 29.9 bcm to 31.0 bcm). In 2020, households used 8.2 bcm of gas, which is 1.3 bcm (13.7%) less than in 2019 due to decrease in temperature-sensitive natural gas demand. Heat production for public institutions and the industrial sector reached 5.1 bcm, which is 2.3 bcm (+42%) more than in 2019 because of low natural gas prices and active use of natural gas for power generation. In 2020, gas consumption by the industrial sector also increased by 1.0 bcm (+12%) to 9.1 bcm.

TOTAL UGS CAPACITY IN UKRAINE

-31 bcm  

NATURAL GAS VOLUME IN EUROPEAN UGS DECREASE

-14.1 bcm  

NATURAL GAS VOLUME IN UKRAINE’S UGS INCREASE

+4.8 bcm
The Law On the Natural Gas Market was adopted in 2015, establishing the principles of free competition and free pricing in competitive gas market segments, as well as development of a liberalized market that allowed to freely choose suppliers and buy gas at a market price. In this respect, the Ukrainian wholesale gas market was gaining ground with the gradual increase in market participants, including traders, importers, suppliers etc. In 2020, Ukraine imported gas exclusively from the European gas market. The number of gas importers in 2020 increased by 12% from 76 companies in 2019 to 85 companies in 2020. Diversifying the delivery of imported gas has contributed to an increase in the number of private suppliers and strengthened competition in the market, which in turn makes the domestic market more efficient and helps end users benefit from affordable competitive prices.

Together with the short-haul service, the “customs warehouse” service offers convenient and attractive conditions (up to 1095 days without any payments of taxes and customs duties) for gas storage in Ukraine’s gas storage facilities. Starting in 2020, more than 82 traders have transmitted gas from the EU to Ukraine, 30 of which were non-residents, with more than 50 companies using short-haul and “customs warehouse” services. Following this, in Q4 2020, natural gas was re-exported for the first time in the country’s history. In summer, suppliers and traders injected gas into UGS facilities using the “customs warehouse” mode and short-haul service that allowed to export this gas later when gas prices rose worldwide.

The European Gas Consumption by Quarters bcm chart shows the consumption in Q1, Q2, Q3, and Q4 for 2019 and 2020, with a quarter-wise breakdown of consumption types: households, heat producers for public sector, public sector and religious organizations, industry, and operating needs.

The EU Gas Consumption by Countries bcm chart shows the consumption by country, with each country's share represented as a percentage of the total consumption.

The Global Gas Demand chart indicates a decrease of 2.5%.

The European Gas Demand chart indicates a decrease of 3.3%.

The Ukraine’s Gas Consumption Growth chart shows a growth of 3.7%.

The Ukraine’s Gas Consumption 2019-2020 bcm chart illustrates the consumption in billions of cubic meters for each year, with the consumption by type: households, heat producers for public sector, public sector and religious organizations, industry, and operating needs.

The PSO Price, UAH/cubic meter incl. VAT chart displays the price according to CMU Decree and Market price Refugee, with historical data from January 2010 to December 2021.
Moreover, in 2020, Naftogaz completely transferred to market pricing, even in supply to the regulated segments (PSO customers). It should be noted that the foundations for the liberalization of gas prices for PSO were laid gradually in 2019, including coupling with market indicators. At the beginning of 2020, a new CMU Decree introducing the import parity approach was adopted. However, at the beginning of March, prices on the local market decreased below import parity levels. This was mainly caused by record high stocks in UGS facilities, warm winter, and lower gas demand. The oversupplied market and full UGS facilities conditioned a decoupling in the Ukrainian market that was not reflecting European trends. 

Starting from March, the PSO price has been set according to the weighted-average prices of the transmission system operator (TSO), adjusted according to gas sale and purchase agreements. It is worth noting that the TSD spread became a market benchmark in 2020. However, in Q4, when 2020 prices demonstrated rapid recovery on the main EU hubs, Ukrainian prices were not that fast-moving, and the decrease in spread (difference) between prices in Ukraine and European hubs narrowed accordingly. This trend was mainly driven by substantial gas stocks in local storage facilities. Following this trend, prices in the domestic market at the beginning of 2021 were already lower than European prices, which provided additional impetus to adopt changes in pricing methodology.

Based on the market benchmark — the weighted average prices that were set on the Ukrainian Energy Exchange for a specific supply month. 2020 was also a notably successful year in terms of gas sales on the Ukrainian Energy Exchange. A total of 2.5 bcm of natural gas was sold, which is 6.5 times more than in 2019. The total number of initiators for trading on the UEEX included 76 companies in 2020, which is almost double compared to the previous year. The largest number of trades was done by GSC Naftogaz Trading, which since July 2019 is an active bidder and plays an important role in increasing liquidity on the UEEX. Moreover, during March and April 2020, 21 regional supply companies have bought natural gas on UEEX that correspond to 49% of the total sales in 2020. That provided additional support to RGKs that helped to escape the market failure when the market liberalization occurred.

Later in October a short-term market was launched at UEEX, where trading is carried out on the intraday market, as well as on the day-ahead market. Using this tool, market participants can plan resource sales and purchases in the short-term market, which significantly increases the liquidity of the participants’ portfolio. The implementation of such services and open borders demonstrates that Ukraine is developing a liquid gas market with increased transparency, openness, and credibility. One of the progress indicators is an annual evaluation of European Federation of Energy Traders (EFET) that rates trading conditions in a specific country with a maximum grade of 20 points. Britain’s NBP, the first gas hub, remains a market leader with maximum score. TTF and NCG hubs, which are the main indicators for Ukrainian traders, have solid scores of 17-19.5 points respectively. According to 2020 data, Ukraine received 9 points. However, only seven years ago, Ukraine did not even feature on the European gas map. In 2017, Ukraine firstly appeared in the annual EFET evaluation report, when the country’s gas market was just opening, with a score of 2. 

KEY RESULTS OF THE RETAIL GAS MARKET:

- Abolition of PSO for households and retail market opening starting from 1 August 2020;
- Implementation of new services and procedures that made it possible to change gas suppliers more than six times faster than under the PSO regime;
- Naftogaz of Ukraine Gas Supply Company (GSC) won a competition and became a supplier of last resort;
- More than 12 gas supply companies entered the segment after the opening of the retail market, including Yasno, ERU, Magewa, OKKO, etc.;
- More than 600,000 customers have changed their gas supplier since the liberalization of the retail gas market. By 1 August 2020, Naftogaz Group completed the transfer to market pricing, with a total number of initiators for trading on the UEEX included 76 companies in 2020, which is almost double compared to the previous year. The largest number of trades was done by GSC Naftogaz Trading, which since July 2019 is an active bidder and plays an important role in increasing liquidity on the UEEX. Moreover, during March and April 2020, 21 regional supply companies have bought natural gas on UEEX that correspond to 49% of the total sales in 2020. That provided additional support to RGKs that helped to escape the market failure when the market liberalization occurred. Later in October a short-term market was launched at UEEX, where trading is carried out on the intraday market, as well as on the day-ahead market. Using this tool, market participants can plan resource sales and purchases in the short-term market, which significantly increases the liquidity of the participants’ portfolio. The implementation of such services and open borders demonstrates that Ukraine is developing a liquid gas market with increased transparency, openness, and credibility. One of the progress indicators is an annual evaluation of European Federation of Energy Traders (EFET) that rates trading conditions in a specific country with a maximum grade of 20 points. Britain’s NBP, the first gas hub, remains a market leader with maximum score. TTF and NCG hubs, which are the main indicators for Ukrainian traders, have solid scores of 17-19.5 points respectively. According to 2020 data, Ukraine received 9 points. However, only seven years ago, Ukraine did not even feature on the European gas map. In 2017, Ukraine firstly appeared in the annual EFET evaluation report, when the country’s gas market was just opening, with a score of 2. The Ukrainian gas retail market has 12.5 million customers who use gas for household needs. Comparing to other European countries, the local retail market is significant in size. For instance, the gas retail market in Poland is estimated at 14.5 million households and ranks seventh in Europe in terms of number of households. Liberalization of the retail gas market showed considerable flexibility of households, and as a result, the number of more than 600 thousand clients have switched their gas supplier during the first five months of the market opening. Moreover, gas price differentiation was one of the key drivers that facilitated people to change a gas supplier.

The market liberalization has contributed to the emergence of new gas supply companies, which have mainly actively competed for the customer, providing a balanced price and a high level of service. In Ukraine today, more than 50 companies supply gas to households. However, depending on the supplier and the region, gas prices differ significantly. For example, the price of gas in December 2020 from Naftogaz of Ukraine was UAH 6.33 per cubic meter, including VAT, while the price of other gas supply companies was on average UAH 8.35 per cubic meter, including VAT. In essence, liberalization of the gas market has caused the situation when the majority of the private gas supply companies set prices in a range of 30%-40% higher than GSC Naftogaz of Ukraine. Such situation on the market forced the government to take action on tariffs’ adjustments. Thus, starting from January 2021, there was a decision to apply a so-called “price cap” for the supply to households on the level of UAH 6.99 including VAT, and transportat-ation costs. According to the household price index report retail gas sales prices in the EU were on average by 28% higher than the gas sales prices in Ukraine. That is mainly explained by the high transportation costs and energy taxes.
### Market and reforms

**Strategy: How our business operates**

**Transformation: How we work**

**Corporate governance**

**Corporate social responsibility**

**Financial overview and statements**

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#### FURTHER MARKET REFORM ACTIONS TO BE TAKEN IN 2021:

- **Development of a data hub.** Data hub must be a unified storage of customer data and their consumption history that should be operated by an independent body. This will allow gas supply companies to compete in a more transparent and effective way for the customer. Data hub will also serve as a useful tool for gas supply companies to improve consumption forecasting and reduce imbalances.

- **Review of current DSO unbundling regulations.** Current DSO unbundling regulations and practices should be compared and aligned to the EU market best practice as well as to the rules of the electricity market. Changes should ensure clear unbundling requirements, proper governance of DSOs’ conduct, prevention of discrimination on non-affiliated suppliers.

- **Consumption forecasting improvement.** Solution on appropriate DSOs incentives should be designed in order to provide accurate forecasts or another forecasting party should be chosen. Transparency and non-discrimination must be ensured in the process of forecasting and data sharing.

- **Retail debt management regulations.** Regulations should facilitate households to not to accumulate their gas debts, while simultaneously provide the opportunities for them to challenge unjustified debt accruals.

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#### Final gas prices for households in EU and CIS countries (with VAT and transportation), UAH/cubic meter

<table>
<thead>
<tr>
<th>Country</th>
<th>Average Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average-2017</td>
<td>8.6</td>
</tr>
<tr>
<td>Slovenia</td>
<td>9.3</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>9.4</td>
</tr>
<tr>
<td>Greece</td>
<td>10.2</td>
</tr>
<tr>
<td>Poland</td>
<td>10.4</td>
</tr>
<tr>
<td>Latvia</td>
<td>10.5</td>
</tr>
<tr>
<td>Serbia</td>
<td>12.4</td>
</tr>
<tr>
<td>Romania</td>
<td>13.6</td>
</tr>
<tr>
<td>Hungary</td>
<td>18.7</td>
</tr>
<tr>
<td>Moldova</td>
<td>20.0</td>
</tr>
<tr>
<td>Ukraine</td>
<td>31.7</td>
</tr>
</tbody>
</table>

Source: https://www.energypriceindex.com/latest-update

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#### Household gas price breakdown

<table>
<thead>
<tr>
<th>Component</th>
<th>Average Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Energy</td>
<td>12%</td>
</tr>
<tr>
<td>Distribution</td>
<td>27%</td>
</tr>
<tr>
<td>Energy taxes</td>
<td>18%</td>
</tr>
<tr>
<td>VAT</td>
<td>33%</td>
</tr>
</tbody>
</table>

Source: https://www.energypriceindex.com/latest-update
Gas balance 2020

Gas sources

- Naftogaz: 1.1
- UkrGasvydobuvannya: 14.2
- Ukrnafta: 1.1
- Private importers: 14.7
- Other: 4.9
- Imports: 15.8
- Production: 20.2

Gas consumption

- 27.5: Gas consumed by users
- 5.1: Heat producers for public sector, religious organizations, industrial sector**
- 1.3: TSO and SSO
- 8.2: Households (direct use)
- 12.9: Households
- 0.9: Ugleyashydobuvannya
- 3.5: Operating needs and technical loss
- 0.4: Public sector and religious organizations
- 1.2: Distribution network*
- 4.7: Heat producers for households***

Gas sources:

- UGS – underground gas storage
- TSO – transmission system operator
- SSO – storage system operator

* including the estimated volume of gas used as unauthorized offtakes (~0.7 bcm)
** including the estimated volume of gas used as unauthorized offtakes (~0.5 bcm)
*** according to Operational Activity Department, Naftogaz
Oil and petroleum products market

OIL MARKET: KEY EVENTS IN 2020

— The situation in the Global oil market in 2020 was unstable compared to the previous year: the Brent price range was USD 53.75–91.88 per barrel against USD 53.75–91.88 in 2019. Virtually uncontrollable falls in prices occurred in March and April 2020 and was due to the introduction of a global lockdown to curb the spread of COVID-19, which significantly reduced demand for fuel and energy; and the failure of the OPEC+ member states negotiations on March 5–6, 2020 to limit production quotas, where the Russian Federation refused to reduce its own crude oil production.

— Subsequent price wars between Saudi Arabia and Russia resulted in a 32% drop in Brent prices from March 6 to 9. The decline continued until the end of April when the price of Brent reached its minimum of USD 9.32 per barrel (24 April, 2020), and the price of WTI – USD (38.96) per barrel (20 April 20, 2020).

— Oil producers gradually reduced production because of the declining consumption and reached the minimum in the second quarter of 2020. Later on demand and supply both recovered among the OPEC+ member states and other major suppliers of crude oil. However, in general, producers have not been able to reach the daily production level observed in January 2020. The average consumption in the OECD member countries, i.e. the world’s most developed economies, also remained lower than at the beginning of 2020, while the total daily consumption in other countries exceeded the January rate.

— The United States retained the status of the largest crude oil producer; however, amid the global economic crisis, the average annual production decreased from 12.25 to 10.32 million bbl/day. A similar trend was observed for other market participants, including Russia and Saudi Arabia, which reduced the average annual production by 17 and 14 percent respectively.

— The decline in spring 2020 was 8.8% while the world GDP decreased by 4.3%.

GLOBAL OIL MARKET

The COVID-19 pandemic was a test for the global economy in 2020. Quarantine restrictions, including spring lockdowns imposed in most countries around the world, and the suspension of international passenger traffic led to a significant reduction in production and services in the second quarter. However, in the subsequent periods, markets have shown rapid growth, mainly due to the removal of some government restrictions.

In the first quarter of 2020, global oil production remained at 100 million bbl/day, in line with the 2019 upward production trend. At the same time, in January 2020, production decreased by 6%, from 102.3 to 96.7 million bbl/day.

The decline in demand for hydrocarbon resources was provoked by both cyclical and seasonal downturns in production and negative expectations amid the rapid spread of COVID-19 in China and OECD member countries. In March 2020, the above-mentioned preconditions for lowering oil prices were compounded by the inconsistency of the positions of the OPEC+ negotiating countries, in particular the Russian Federation and Saudi Arabia, on the reduction of oil production quotas. During the Vienna negotiations on 4-6 March 2020 the parties did not agree to extend production restrictions, and the Russian Federation refused to join OPEC members in reducing oil production. In response, Saudi Arabia started a price war, offering discounts of USD 6.8 per barrel for buyers from the US, EU and Asia. In addition, Saudi Aramco announced plans to increase production in April from 9.7 to 12.3 million bbl/day. These actions led to a temporary price collapse, Brent quotations fell by 32% from 6 to 9 March. The average Brent price in USD was 18.38 per barrel (the minimum Brent price during the year was USD 9.12 per barrel, recorded on 21 April. For the first time in history, WTI and Brent prices were negative.

From the middle of the second quarter, the global oil market witnessed an increase in prices amid the gradual lifting of epidemiological restrictions and reduction of production in May and June 2020 to 9.7 million bbl/day (under the OPEC+ agreement reached on 1 May 2020). In May 2020, global oil production fell to 88.57 million bbl/day, a drop of 1.6% from the beginning of the year. The sharp decline contributed to higher prices, in particular, at the end of the second quarter, the Brent quotations rose to USD 41.64 per barrel.

In subsequent months, the upward trend in prices continued in parallel with the COVID-19 dynamics. For example, in the autumn the price fluctuated according to the background of negative forecasts for the likelihood of new lockdowns in most developed countries in Europe. However, in early November, news about successful Pfizer Inc and BioNTech trials led to rising oil prices in anticipation of the positive impact of national vaccination programs on the global economy. From early November to late December, Brent prices rose from USD 51.22 per barrel.

The first quarter of 2021 was a period of significant growth in crude oil stock prices. In particular, the lowest Brent price was recorded on 4 January – USD 50.37 per barrel, and the highest on 5 March – USD 69.69 per barrel (from the beginning of 2021 the price increased by 39%, from mid-February 2020 – by 70%).

The Saudi Arabia statement on 5 January 2021 about the plans to voluntarily cut their own production by 1 million bbl/day in the next two months triggered the quotation growth. Also, drivers of the rise in prices included the data on the reduction of crude oil stocks in the United States, the weakening dollar, optimism about vaccination programs, and the expectations of unprecedented measures to stimulate the US economy to be implemented by the new government. Earlier this year, US President Joe Biden announced his intention to launch a program to help Americans overcome the effects of the COVID-19 pandemic worth USD 1.9 trillion.

The main factor holding back the rise in prices was the difficult epidemiological situation, including the reintroduction of quarantine restrictions in China and the OECD countries. In February 2021, the prices continued to rise as investors remained optimistic about the effects of vaccination programs and the lifting of epidemiological restrictions. In addition, Saudi Arabia followed its production shortening plans announced in January. However, since the beginning of March 2021, the prices have returned to significant fluctuations. The main reasons for the fall in prices were a rapid increase in the incidence of COVID-19 (including the emergence of new strains), the reintroduction of restrictions in the EU and China, as well as news of side effects from vaccines. In addition, crude oil inventories in the United States began to rise in February. According to the OPEC report for February 2021, average daily demand will increase by 220 thousand bbl/day, which will have a positive impact on price dynamics, but the rise should be expected in the third quarter of 2021.

On 23 March 2021, the Evergreen Ever given container ship ran aground in the Suez Canal, completely blocking the sea connection between the Red and Mediterranean Seas for the next week. As 11% of the global trade passes through the canal every day, including 1 million barrels of crude oil, the blockade was reflected in stock quotes. Thus, Brent crude on 23 March surged from USD 60.79 per barrel to USD 75.41 per barrel for the next day and up to USD 64.98 per barrel in a week.

OIL PRODUCTION

During 2020, crude oil production in the United States, the Russian Federation, and OPEC countries accounted for about 54% of the world’s average annual crude oil production. The dynamics of output in the countries was almost synchronous: production remained stable until April, the second quarter showed reduced volumes (Saudi Arabia was the only one to increase output by 18.6% in April 2020 to put pressure on Russia in the price war, but later was forced to reduce volumes due to a sharp decline in demand), and subsequently production entered a phase of slight growth.

Unlike the previous years, in 2020 the reduction in OPEC+ member countries output did not drive the US shale oil producers to expand their production. US crude oil consuming companies have also faced the impact of epidemiological constraints, which have forced them to reduce their own consumption, thereby shortening overall demand. A significant drop in prices from March to May led to the exit of a number of companies. WTI and Brent declined from USD 6.82 to oil rigs were operating in the United States, at the beginning of May their number dropped to 325. On 14 August, only 173 rigs continued their operations – the lowest number in the last 10 years. In general, the United States retained the status of the largest producer of crude oil but the daily output also decreased, falling from 12.25 to 10.32 million bbl/day amid the global economic crisis. Other market participants demonstrated a similar trend, in particular the Russian Federation and Saudi Arabia which reduced the average annual value of daily production by 17% and 14% respectively.

Oil prices fluctuated in 2019-2020, USD/bbl

Global oil supply and demand

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2021 F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil production, million bbl/day</td>
<td>100.78</td>
<td>100.61</td>
<td>94.23</td>
<td>97.13</td>
<td>100.62</td>
</tr>
<tr>
<td>Total consumption, million bbl/day</td>
<td>100.05</td>
<td>101.18</td>
<td>92.21</td>
<td>97.77</td>
<td>107.08</td>
</tr>
<tr>
<td>Supply to demand ratio</td>
<td>0.72%</td>
<td>-0.56%</td>
<td>2.19%</td>
<td>-0.66%</td>
<td>-0.46%</td>
</tr>
</tbody>
</table>

Brent price fluctuation range, USD/bbl

<table>
<thead>
<tr>
<th>Range</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Min</td>
<td>$43.98</td>
<td>$50.57</td>
<td>$53.23</td>
<td>$9.12</td>
</tr>
<tr>
<td>Max</td>
<td>$66.80</td>
<td>$66.97</td>
<td>$74.94</td>
<td>$70.25</td>
</tr>
</tbody>
</table>
At the same time, the fall in orders from refineries contributed to an increase in oil inventories and the demand for oil storage facilities. On 19 June 2020, US commercial crude oil inventories reached a record 540.7 million bbl, which is 19% higher than in March, when the United States declared the state of emergency. Oil stocks in Cushing, the main oil trading hub (WTI) in the United States, reached 83% of the total available capacity. In the third and fourth quarters of 2020, the news of declining crude oil stocks was perceived by traders as positive signals and pushed prices up.

The supply of crude oil by OPEC member countries in 2020 fell by 11.72% compared to the previous period. The average production by other countries decreased by 3.48% (12 million bbl/day). In the coming periods, according to EIA forecasts, production is expected to increase both among OPEC members and among other producers. In particular, in 2021, OPEC countries are expected to raise crude oil output by 5.39% (1.65 million bbl/day). Other producers are projected to expand their volumes by 1.89% to 64.89 million bbl/day. In 2022, the supply of OPEC states may increase by 3.80%, and of other countries – by 3.49%. At the same time, total daily production will exceed the volume produced in 2019 – 100.609 million bbl/day.

**OIL DEMAND**

According to the EIA, global demand for crude oil fell by 8.86% in 2020. In OECD member countries, average annual demand dropped by 11.8%, from 47.5 to 42 million bbl/day. In other countries, oil consumption declined by 6.3%. According to the EIA forecasts, oil consumption in 2021 for both groups of countries will increase by 6%. The projected demand for 2022, compared to 2021, will expand by 3.2 million bbl/day (3.1%).

**EUROPEAN OIL REFINING MARKET**

2020 was the year when European refining experienced a disruption of the balance that had been observed in the market for the past two years. In particular, the average annual refinery utilization rates in the EU-16 decreased from 84% to 72% compared to the previous period. The average refining margin for Brent fell by 63% from USD 1.5 per barrel in 2019 to USD 2.17 per barrel in 2020. Meanwhile, the average spot price for Brent oil for the same period dropped by 35% to USD 42 per barrel.

During 2019, the price of Brent crude oil fluctuated almost synchronously with the refinery utilization rates, which allowed refineries to maintain a virtually stable margin compared to 2018, and thus the same level of profitability. The price and the use of refining capacity increased during March-June 2019, reaching a peak of 88.30% in June. The rate decreased to 79.58% in September.

In early 2020, Europe’s oil refining industry experienced a period of recovery, mainly due to planned turnarounds (technological maintenance) among the Middle East competitors. In January, the average refining margin was USD 4.96 per barrel against USD 2.54 per barrel for the previous month. However, as early as in February, following a decrease in the number of flights due to the spread of COVID-19 and the low demand for fuel amidst the warm winter, the profitability of oil refining decreased.

Since the beginning of spring, the low price of raw materials and the turnarounds of multiple refineries resulted in a growing refinery margin, which was under the pressure from declining demand due to the introduced lockdown. However, in May, the profitability of oil refining fell to almost zero, as optimistic expectations of producers in early spring led to the extremely high stocks of finished products.

The things changed only at the beginning of the third quarter of 2020, when increased export supplies and the removal of some restrictions on passenger traffic led to a growth in demand for European refined petroleum products. However, this situation did not last long, and in August, when some of Middle East refineries were back from technological downtime, the average monthly margin dropped below USD 0.2 per barrel.

October 2020 was the month of margin growth to the USD 1.9 per barrel, but mainly due to the fact that a number of European and Russian refineries were on turnarounds. The end of 2020 witnessed a decrease in profitability due to the reintroduction of severe epidemiological restrictions, as well as the accumulation of stocks and the return of several refineries from the planned maintenance inactivity back to operations.

The coronavirus pandemic negatively affected European refining. The decline in demand for energy and fuel caused by the curtailment of business activity led to a decrease in refining margins, reduced production, and temporary decommissioning of less profitable refineries. Production of petroleum products in 2020 decreased by 10% compared to the previous year, amounting to 590.13 million tons. In the range of petroleum products, the largest changes were in production of fuel oil, which decreased by 22% to 63.3 million tons due to a decline in demand for services and industry demand. Exports of European petroleum products also fell by almost 10% to 153.9 million tons amid declining demand for fuel oil. Production of gasoline (7%) and kerosene (13%) also decreased significantly.

**Trends for the coming years**

Given the trends in the spread of COVID-19, including the emergence of new strains, epidemiological restrictions in most countries will remain in force or will be renewed, which will not contribute to the increase in consumption of refined products. Thus, the refining margin is expected to stay low. On the other hand, several European manufacturers have announced the plans to close their refineries. This process, however, will be in parallel to the return of the Middle Eastern and Russian refineries from maintenance inactivity to active operations. Meanwhile, markets will likely remain overstocked due to the introduction of new measures to contain the COVID-19 pandemic. According to Euroilstock, the distillate stocks in the EU-15 and Norway in November 2020 reached the highest level in 30 years. It is the increase in inventories that manufacturers, including Naftogaz and Gunvor, are referring to, arguing for temporary or permanent closure of their divisions. Oil refining...
in Europe is expected to decline by 1 million barrels per day next year, however global production will exceed consumption by 22 million barrels per day.

The transition to biofuels and hydrogen remains an important trend in the coming years. In particular, Tall, Eric and Repsol have announced the plans to reform their own assets to produce the environmentally-friendly energy.

**OIL AND PETROLEUM PRODUCTS MARKET OF UKRAINE**

The Ukrainian market of crude oil and gas condensate is replenished with the national product and import supplies. Naftogaz Group, which includes Ukrafta (50% + 1 share of the company is owned by Naftogaz of Ukraine) and Ukrugasobuvannya (100% of the company’s shares are owned by Naftogaz of Ukraine), is the largest producer of oil and gas condensate in Ukraine. In 2020, almost 80% of 2.4 million tons of total output were produced on these enterprises. As a result, the share of domestic oil and gas condensate processing increased from 78% in 2019 to 81%.

According to Argus, Naftogaz Group increased the output of crude oil to Ukraine in 2020 amounted to 1.21 million tons, of which almost 97% were delivered to the Kremenchuk refinery of Ukrafta. Another 182 thousand tons were purchased by Ukrtransnafta, which is part of the Naftogaz Group, and traded in the same year when a favorable price situation was established.

**Oil refining**

The largest domestic enterprises specializing in oil and gas condensate processing are the Kremenchuk refinery, which receives Ukrtransnafta’s raw materials, and the Shabelykha refinery, which operates on Ukrugasobuvannya’s production. These companies produce Euro 5 motor fuel. Operations of oil refineries in Ulyanchyn, Odessa, Nadzvyn, Drobobych and Kherson have been stopped. This creates the need for a significant share of imports of petroleum products on the domestic market.

According to Argus, the volume of refining at the Kremenchuk and Shabelykha plants increased by 232 thousand tons, or 7.3% compared to 2019, amounting to 3.34 million tons. This is the largest throughput recorded since the beginning of 2014.

The volume of crude oil processing at the Kremenchuk refinery increased to 2.92 million tons (an increase of 11.5% compared to 2019), the highest number in the last 10 years. At the same time, the processing on the Shabelykha refinery dropped by 50 thousand tons (11% of processing in 2019) to 422.5 thousand tons. The main reason for performance shortening was the reduction of processing margin in the spring of 2020.

**Gasoline**

Demand for diesel fuel in 2020 was not strongly influenced by the introduced quarantine restrictions, as this product is widely used in the productive sectors of Ukraine’s economy. Thus, the volume of diesel fuel consumption in Ukraine in 2020 increased by 4% to 7.38 million tons.

According to Argus, in 2020 the Kremenchuk refinery increased the output of diesel fuel by 346 thousand tons (46% of the total volume of 2019), to 1.11 million tons—the best performance for the last 10 years. Production of diesel fuel on the Shabelykha plant fell by 14.8% (or 13.1 thousand tons) to 75.2 thousand tons. The vast majority of diesel fuel came to the market from foreign manufacturers.

According to analytical data from Argus and ExPro, imports in 2020 decreased by 31 thousand tons compared to a record figure in 2019—to 6.19 million tons. The main counterparties include the Russian Federation, Belarus, Lithuania, as well as Turkey and Greece by sea supplies. The leading provider of diesel fuel was the Russian Federation—2.6 million tons, or 42.2% of imports, most of which were produced by Rosneft (according to ExPro). The bulk of Russian fuel came through pipelines—67% of total imports. It should be noted that for the first time since 2016, the products of the Moscow and two Nizhnekamsk refineries were imported.

In 2020, the volume of imports from Belarus declined by 11.6% to 2.19 million tons, deliveries of the Mosy refinery amounted to 2.04 million tons, a decrease of 3%.

According to Argus analysts, this reduction is mainly due to the orientation of Belarusian suppliers, including Nafanft, to the Baltic countries.

**Gasoline**

The estimated balance of the Ukrainian gas market in 2020 increased by 115.4 thousand tons compared to 2019—to 2.13 million tons, major portion of sales took place through gas stations—about 75% (according to Argus). At the same time, in the spring of 2020, gasoline sales and demand for products were under pressure from quarantine restrictions imposed by the Government of Ukraine to prevent the spread of COVID-19 disease (in particular, suspending long-distance passenger traffic).

The total volume of gasoline production by Ukrainian enterprises in 2020 increased by 6.6% and amounted to 1.04 million tons. The lion’s share of this volume was produced on the basis of Kremenchuk refinery—901.8 thousand tons, 9% higher than in 2019. At the same time, out of 74.8 thousand tons of total growth, 58 thousand tons fell on gasoline A-92. Production of A-95 gasoline also rose by 3.8% to 352 thousand tons.

According to Argus, in October 2020 the company put into operation an isomerization unit with a capacity of 350 thousand tons/year, which allows increasing the share of the A-95 gasoline to 80% of the total volume of gasoline produced.

The launch allowed Ukrtransnafta to reduce its imports of methyl-tert-butyl ether, same as the production of benzol refining raffinate.

Gasoline output at the Shabelykha refinery decreased by 6.4% to 139.6 thousand tons. Whilst the production of A-92
According to ExPro, import deliveries also decreased dramatically – a drop of 48.5%, setting the total volume of purchases at around 136 thousand tons. The main suppliers were Lithuania (63.3 thousand tons), Greece (35.6 thousand tons), Belarus (19 thousand tons) and Italy (17.9 thousand tons).

Autogas and LPG

During the reporting period, the autogas and LPG market also remained under significant pressure due to the introduction of quarantine restrictions. According to Argus, sales of this product could resume only in the fall of 2020, and a temporary decline in demand led to the formation of large stocks.

However, the total volume of LPG consumption in Ukraine in 2020 increased by 55.9 thousand tons (2.9% of the volume in 2019), reaching 1.98 million tons. LPG production at Ukrainian plants in 2020 decreased by 25.6 thousand tons to 432.6 thousand tons of total production. At the same time, the domestic producers’ performance differed.

Ukravtodor and Ufaتينس، the largest producer of LPG in Ukraine, reduced production for the seventh year in a row. The output decreased by 5.5% to 144.32 thousand tons. LPG volumes produced by Ukravtodor increased by 4.5% to 117 thousand tons. According to the consulting company A-95, the Kremenchuk refinery of Ukravtodor also significantly reduced its performance by 14.1%, stopping at 105.3 thousand tons. Among the companies that produce smaller volumes, the Poltava Gas and Oil Company experienced a decrease in output by 6.9%, to 12.8 thousand tons.

The only producer of aviation gas in Ukraine is the Kremenchuk refinery. The Kremenchuk refinery of Ukravtodor also produced aviation gas for the seventh year in a row. The output decreased by 14.1%, stopping at 105.3 thousand tons. The output of A-95 fell by 26.7% to 94.4 thousand tons, output of A-95 increased by 43% to 31.8 thousand tons. Also, in 2020, A-80 gasoline was manufactured at the request of the Ministry of Defense of Ukraine.

According to the consulting company ExPro, gasoline imports to Ukraine in 2020 increased by 61.6 thousand tons (5.9%) compared to the previous year and amounted to 1.09 million tons. The largest importers were Belarus and Lithuania. Thus, exports from Belarus grew by 22.8% (or 118.4 thousand tons) – to 857.2 thousand tons. The main supplier was the Mozor Refinery - 823.0 thousand tons, 32.2% more than in the previous period. Novopolotsk Refinery (Naftan) delivered a relatively small amount of 28.9 thousand tons in favor of RSOU- Nafta. Imports of lithium gasoline produced by Orlen, according to ExPro, amounted to 232.3 thousand tons, which is 29.4% lower than the volume of deliveries in 2019.

The product structure of imports was dominated by A-95 gasoline - about 68% of total deliveries. Also, 334.6 thousand tons of A-92 and minor volumes of A-100 and A-98 gasoline were imported (as per Argus statistics).

Due to the introduction of quarantine restrictions in 2020, air traffic decreased more than half, which caused the fall of the Ukrainian aviation fuel market by 44.7% to 272.4 thousand tons.

The only producer of aviation gas in Ukraine is the Kremenchuk refinery. In 2020, the output at this enterprise fell by 29.5% to 105.3 thousand tons. The only producer of aviation gas in Ukraine is the Kremenchuk refinery. In 2020, the output at this enterprise fell by 29.5% to 105.3 thousand tons.

Also, in November 2020, Ukrtransnafta transported 13.07 million - 54.5 thousand tons (or 0.4%) less than in 2019. The volume of crude oil increased by 1.5% compared to the previous year, amounting to 15.7 million tons. Almost 2.6 million tons (8.6% higher than in the previous period) were delivered to Ukrainian refineries, and 2.18 million tons of this oil (or 84%) came to the Kremenchuk refinery.

At the same time, the volume of oil transit decreased to 13.07 million - 54.5 thousand tons (or 0.4%) less than in 2019. For the first time on 7 June 2020, Ukrtransnafta transported “light Texas” oil – West Texas Intermediate (WTI). The customer of this operation was the Kremenchuk refinery. In total, the company has experience in transporting five varieties of imported oil: Urals, Azeri Light, Bakken, El Shara and WTI. Also, in November 2020, Ukrtransnafta transported 79.9 thousand tons of oil to Belarus under a purchase agreement concluded with BGN (UK) Limited.
Gas Transit Organization Services

KEY SEGMENT RESULTS FOR 2020:

— Due to the successful implementation of unbundling process, certification of the GTS Operator of Ukraine (Gas TSO) as the operator of gas transmission system, and conclusion of the Agreement on Settlement of Existing Gas Disputes and the Agreement on Services for Organization of Natural Gas Transmission through the territory of Ukraine dated 30 December 2019 between Naftogaz and Gazprom (Transit Agreement), the terms of the utilization of the GTS of Ukraine to transport natural gas to European countries was agreed for the period 2020-2024. In order to implement these arrangements, the Company began operations as the organizer of the transit services, assuming the risks of changes in Ukrainian legislation and gas market regulations.

— According to the concluded agreements, in December 2019, Naftogaz received a compensation from Gazprom of USD 2.92 billion under the arbitration decision on the 2018 transit case.

— The new Agreement on Organization of Transit set forth ship-or-pay principle, which guarantees pre-payment for booked capacity, regardless of the actual volume of transportation, and a separate fee for additional capacity booked within a year. These new terms replaced the Transit Contract for 2009-2019 based exclusively on payment for the actual volume of natural gas transported to Europe through gas transportation system. At the same time, it should be noted that Transit Contract ended on January 1, 2020 and the new Transit Agreement for the period 2020-2024 could not be compared since they are based on different principles.

— In 2020, the volume of Russian natural gas transported by the Ukrainian GTS to Europe amounted to 55.8 bcm. In 2019, the volume was 89.6 bcm.

— The net revenue of the segment in 2020 amounted to UAH 46.7 billion; the segment result was UAH 1.7 billion. Taking into account a set of new signed agreements on the organization of transit, 2020 figures cannot be compared with 2019 results.

Due to the expiration date of the Transit Contract for 2009-2019 with Gazprom, in late December 2019, Naftogaz and Gazprom concluded a number of agreements according to the arrangements between representatives of Ukraine, the European Union, and the Russian Federation and in order to settle liabilities determined by the Resolutions of the Arbitration Institute of the Stockholm Chamber of Commerce on the disputes between Naftogaz of Ukraine and Gazprom.

Naftogaz, Gas TSO, and Gazprom signed a set of agreements necessary for the continuation of natural gas transportation activities by Gazprom through the territory of Ukraine until 2024. The package includes three major agreements:

1. Intercollection Agreement signed by Gas TSO and Gazprom (as the operator of the Russian GTS), which provides for technical regulations and rules of interaction between the operators of adjacent networks;
2. Agreement on the Organization of Gas Transmission through the territory of Ukraine between Naftogaz of Ukraine and Gazprom, which provides the terms and annual booking capacity of the GTS of Ukraine for the next five years (2020-2024);
3. Agreement on Settlement of Existing Gas Disputes and Basic Terms of Future Relations in respect of transportation of natural gas between Naftogaz of Ukraine and Gazprom. According to this agreement, the parties waive any mutual claims under the 2009 contracts and set their mutual activities and obligations for the future work.

These results have been achieved owing to the 5-year work of the Naftogaz team across the following directions:
— successful arbitration cases against Gazprom;
— measures on recovering funds from Gazprom to implement the resolution of the Stockholm Arbitration Institute;
— introduction of mandatory sanctions by US authorities, which suspended the construction and commissioning of Nord Stream 2 gas pipeline in the previously planned term;
— support provided by the European Commission and the Energy Community Secretariat for the reform of Ukrainian gas market legislation, which has ensured timely implementation of unbundling and certification of the independent Gas TSO of Ukraine.

European institutional support of Ukraine’s position in negotiations with the Russian party in resolving issues following the resolutions of the Arbitration Institute of the Stockholm Chamber of Commerce and further principles, terms, and volumes of ordering capacities of the Ukrainian GTS.

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### Volumes of gas transportation according to the Agreement on Organization of Gas Transmission through the territory of Ukraine with Gazprom in 2020-2024, bcm

<table>
<thead>
<tr>
<th>Year</th>
<th>Planned</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
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<td>55.8</td>
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<tr>
<td>2021</td>
<td>60.0</td>
<td>60.0</td>
</tr>
<tr>
<td>2022</td>
<td>60.0</td>
<td>60.0</td>
</tr>
<tr>
<td>2023</td>
<td>60.0</td>
<td>60.0</td>
</tr>
<tr>
<td>2024</td>
<td>60.0</td>
<td>60.0</td>
</tr>
</tbody>
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### Volumes of gas transportation to Europe through the territory of Ukraine

<table>
<thead>
<tr>
<th>Year</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of transit gas volumes transported from Russia to Europe through the territory of Ukraine, bcm</td>
<td>93%</td>
<td>85%</td>
<td>88%</td>
<td>86%</td>
<td>80%</td>
<td>70%</td>
</tr>
<tr>
<td>Share of transit gas volumes transported to Europe through the territory of Ukraine, bcm</td>
<td>95%</td>
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<th>Year</th>
<th>2015</th>
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<td>70%</td>
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**Gas Transit Organization Services**

**Naftogaz of Ukraine – A Reliable Partner for Gas Transportation Organization Service**

In 2020, the company concluded a standard agreement under which natural gas transportation is carried out by Gas TSO. According to the European regulations, Gas TSO is the GTS operator completely independent of vertically integrated enterprises, and ensures reliable operation of the GTS of Ukraine for Ukrainian consumers, provides services to foreign suppliers and customers, transports Russian gas through the GTS of Ukraine to Europe. The company also booked the relevant capacity of entry and exit points of the Ukrainian GTS to ensure registration of reception, transportation, and transmission of natural gas to European consumers. According to the new agreement dated 30 December 2019, the volume of annual capacity booking for transit from

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**Key segment results for 2020:**

- Due to the successful implementation of unbundling process, certification of the GTS Operator of Ukraine (Gas TSO) as the operator of gas transmission system, and conclusion of the Agreement on Settlement of Existing Gas Disputes and the Agreement on Services for Organization of Natural Gas Transmission through the territory of Ukraine, the terms of the utilization of the GTS of Ukraine to transport natural gas to European countries was agreed for the period 2020-2024. In order to implement these arrangements, the Company began operations as the organizer of the transit services, assuming the risks of changes in Ukrainian legislation and gas market regulations.

- According to the concluded agreements, in December 2019, Naftogaz received a compensation from Gazprom of USD 2.92 billion under the arbitration decision on the 2018 transit case.

- The new Agreement on Organization of Transit set forth ship-or-pay principle, which guarantees pre-payment for booked capacity, regardless of the actual volume of transportation, and a separate fee for additional capacity booked within a year. These new terms replaced the Transit Contract for 2009-2019 based exclusively on payment for the actual volume of natural gas transported to Europe through gas transportation system. At the same time, it should be noted that Transit Contract ended on January 1, 2020 and the new Transit Agreement for the period 2020-2024 could not be compared since they are based on different principles.

- In 2020, the volume of Russian natural gas transported by the Ukrainian GTS to Europe amounted to 55.8 bcm. In 2019, the volume was 89.6 bcm.

- The net revenue of the segment in 2020 amounted to UAH 46.7 billion; the segment result was UAH 1.7 billion. Taking into account a set of new signed agreements on the organization of transit, 2020 figures cannot be compared with 2019 results.

- Due to the expiration date of the Transit Contract for 2009-2019 with Gazprom, in late December 2019, Naftogaz and Gazprom concluded a number of agreements according to the arrangements between representatives of Ukraine, the European Union, and the Russian Federation and in order to settle liabilities determined by the Resolutions of the Arbitration Institute of the Stockholm Chamber of Commerce on the disputes between Naftogaz of Ukraine and Gazprom.

- Naftogaz, Gas TSO, and Gazprom signed a set of agreements necessary for the continuation of natural gas transportation activities by Gazprom through the territory of Ukraine until 2024. The package includes three major agreements:

  - Agreement on the Organization of Gas Transmission through the territory of Ukraine between Naftogaz of Ukraine and Gazprom, which provides the terms and annual booking capacity of the GTS of Ukraine for the next five years (2020-2024);
  - Agreement on Settlement of Existing Gas Disputes and Basic Terms of Future Relations in respect of transportation of natural gas between Naftogaz of Ukraine and Gazprom. According to this agreement, the parties waive any mutual claims under the 2009 contracts and set their mutual activities and obligations for the future work.

- These results have been achieved owing to the 5-year work of the Naftogaz team across the following directions:
  - Successful arbitration cases against Gazprom;
  - Measures on recovering funds from Gazprom to implement the resolution of the Stockholm Arbitration Institute;
  - Introduction of mandatory sanctions by US authorities, which suspended the construction and commissioning of Nord Stream 2 gas pipeline in the previously planned term;
  - Support provided by the European Commission and the Energy Community Secretariat for the reform of Ukrainian gas market legislation, which has ensured timely implementation of unbundling and certification of the independent Gas TSO of Ukraine.

- European institutional support of Ukraine’s position in negotiations with the Russian party in resolving issues following the resolutions of the Arbitration Institute of the Stockholm Chamber of Commerce and further principles, terms, and volumes of ordering capacities of the Ukrainian GTS.
Gazprom amounted to 65 bcm (178.1 mcm a day) in 2020 and 40 bcm (109.6 mcm a day) every year during the period of 2021 through 2024. In 2020, the actual volume of natural gas transported by Gazprom to Europe through the territory of Ukraine amounted to 55.8 bcm, which is 38% less than in 2019 and 14% less than anticipated in the annual capacity booking for 2020 under the new Agreement on Organization of Gas Transit. The main reasons for the decrease in transit to Europe were the launch of Russia’s new gas pipelines bypassing Ukraine, decrease in demand for Russian natural gas in the European Union, and availability of significant gas reserves in European underground gas storage facilities in 2020.

Since the terms of the Gas Transit Agreement include an advance payment of the booked capacity of 65 bcm, regardless of the actual volume of gas transportation (ship-or-pay principle), the company received about USD 2.07 billion from Gazprom for services provided in 2020 (excluding the fee for additional capacity and the advance payment for January 2021). The net revenue of the segment in 2020 amounted to UAH 46.7 billion; the segment result was UAH 1.7 billion.

Furthermore, taking into account Gazprom’s interest in supplying additional volumes of gas to the European consumers in the fourth quarter of 2020 and by individual orders, Naftogaz participated in monthly capacity booking auctions on the RBP (Hungary) and GSA (Poland) platforms. By results of auctions, the company has secured additional gas transportation capacity of more than 4 mcm a day in October, over 10 mcm a day in November, over 11 mcm a day in December, and a record volume of 41.2 mcm a day in January 2021.

The company fully settled with the Gas TSO of Ukraine and concluded the relevant Annexes to the Agreement with the Gas TSO of Ukraine to ensure operations in 2021. In 2020, Naftogaz of Ukraine complied with all provisions of a set of agreements concluded in late December 2019 and ensured reliable organization of natural gas transportation through Ukraine in 2020, which was carried out directly by the Gas TSO of Ukraine. In addition, according to the provisions of the Agreement with Gazprom, 24-hour dispatching of orders at cross-border entry and exit points was organized using the information platform of the GTS Operator of Ukraine for submitting nominations.

The process of the company’s participation in auctions for booking annual, quarterly, monthly, and day-ahead capacities has also been mastered, subject to the provisions of the GTS Code and the resolutions of the National Energy and Utilities Regulatory Commission, adopted in the middle of 2020.

CHANGES IN THE REGULATORY FRAMEWORK TO ENSURE THE IMPLEMENTATION OF AGREEMENT TERMS

During the aforementioned works, a number of issues have been identified regarding the procedures provided for by the GTS Code of Ukraine and legislative acts that stipulate the rules of operations in the Ukrainian gas market. In 2020, at the request of Naftogaz and other gas market participants, a number of amendments were introduced to certain resolutions of the NEURC on the abolition of coefficients that take into account the period and the season for which the capacity is booked. These amendments have improved market performance. Moreover, obstacles have been identified in the rules for conducting capacity-booking auctions, as well as working issues with the Gas TSO of Ukraine, which should be addressed in the near future on the company’s initiative.

In 2021, Naftogaz will continue carrying out the operations and fulfilling the obligations set forth in the Agreement with Gazprom, based on the planned booked capacity of the Ukrainian GTS of 40.0 bcm a year. The planned revenue from contract implementation in 2021 amounted to USD 1.27 billion. It is expected the company will pay about 97% of the total revenue to the Gas TSO of Ukraine. At the same time, Gazprom is entitled to book additional annual, quarterly, monthly, and day-ahead capacities, payments for which will also increase the revenues of the company and the Gas TSO of Ukraine.

UNCERTAIN FUTURE: NORD STREAM 2 GAS PIPELINE

Although the Agreement with Gazprom will be valid for another four years, its implementation faces external (political and economic) and internal risks. In particular, it is important to prevent further diminution of Ukraine’s role as a transit country, specifically by reinforcing sanctions imposed on the Russian Federation due to aggression in eastern Ukraine and annexation of the Crimean peninsula, and by blocking the completion of construction and commissioning of the Nord Stream 2 gas pipeline.

In December 2020, the US House of Representatives and Senate adopted the 2021 US Defence Budget Bill. The bill provides for the introduction of new sanctions related to the Nord Stream 2 gas pipeline. Sanctions must be applied to companies that promote the sale, lease, or provision of pipe-laying vessels for the construction of gas pipelines, as well as to companies that provide insurance coverage for vessels involved in construction.

Furthermore, on 21 January 2021, the European Parliament adopted the Resolution to call for a critical review of cooperation with Russia on various foreign policy platforms and for stopping the final stages of construction of the Nord Stream 2 gas pipeline.

The Company supports the decisions of the United States and the European Parliament aimed at enhancing competition in energy markets and preventing the completion of Nord Stream 2. Joint efforts are the pillar for the collective security of the transatlantic community.
Key regulatory changes in 2020

In 2020, changes in legislation had a generally positive impact on Naftogaz Group activities. First, the Ukrainian natural gas market was opened for consumers from August 1, 2020, and, as a consequence, the public service obligations assigned to Naftogaz in gas supply to households were terminated. Pursuant to the adopted Laws of Ukraine No 1006-IX, No 1005-IX of 17.11.2020 and CMU Resolutions No 1194, No 1195 of 03.12.2020, Naftogaz Group received compensation from sales of imported gas at a regulated price below cost under PSO, and Ukrafta PJSC fully repaid its tax debt to the state.

Naftogaz Group made a significant step forward in institutional use. It was granted the rights to explore and extract hydrocarbons in the Yuzivska area and on the continental shelf and exclusive (marine) economic zone of Ukraine. In addition, in October 2020, the CMU approved the Naftogaz of Ukraine Ownership Policy and the Company’s updated Charter which was amended in line with the OECD Guidelines on Corporate Governance of State-Owned Enterprises.

Changes in regulatory

The CMU identified Naftogaz of Ukraine Gas Supply Company LLC as a “last-resort” supplier for a period of three years as the winner of the tender to secure reliable supply of natural gas to consumers on 22.07.2020. In addition, on 23.09.2020, NEURC optimized the procedure for concluding a natural gas supply contract between consumers and “last-resort” suppliers, as well as improved relations between them (Resolution No 1752). Simplified mechanisms were introduced for entering consumers in the register of the “last-resort” supplier on the information platform of the GTS operator.

The Verkhovna Rada adopted the Law of Ukraine No 553-IX of 13.04.2020, according to which enterprises of centralized water supply and sewerage regardless of ownership, as well as heat producers regardless of ownership, were exempted from fines and penalties by suppliers of electricity and natural gas for the period of quarantine or restrictive measures related to the coronavirus pandemic.

On 01.01.2020, the CMU Resolution No 17 of 24.01.2020 liberalized the wholesale prices for natural gas supplied for the needs of households and heat producers, and made them equal to import parity prices. This was one of the Ukraine’s obligations to the IMF regarding the phased transition to a natural gas market with free pricing and competition for households between gas suppliers.

On 10.06.2020, NEURC changed the conditions for concluding a natural gas supply contract between households and a new supplier and, as a result, simplified the procedure for changing the natural gas supplier (Resolution No 1080).

The public service obligations of Naftogaz of Ukraine NJSC were terminated on 01.08.2020 regarding natural gas sales to suppliers for the needs of households and natural gas and heat producers regardless of ownership, were exempted from fines and penalties by suppliers of electricity and natural gas for the period of quarantine or restrictive measures related to the coronavirus pandemic.

On 19.02.2020, the CMU approved the new version of the Procedure for Granting Special Permits for Subsoil Use. The key point was elimination of the need to agree with the Law No 1006-IX “On the State Budget of Ukraine for 2020” (Resolution No 1195), necessary to implement the Law No 1006-IX.

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On 03.12.2020, the Government approved the Procedure for Determining Compensation Provided to Natural Gas Market Entities with Public Service Obligations (Resolution No 1194) and the Procedure for Use of Funds Provided for in the State Budget to Implement Measures Specified in Paragraphs 31-33 of Article 14 of the Law of Ukraine No 294-IX ‘On the State Budget of Ukraine for 2020’ (Resolution No 1195), necessary to implement the Law No 1006-IX.

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Granting the right to explore and extract hydrocarbons in the Yuzivska area and on the continental shelf and exclusive (marine) economic zone of Ukraine was an important event for Naftogaz Group. On 25.11.2020, the CMU made amendments to the Procedure for Granting Special Permits for Subsoil Use (Resolution No 1172), which provides for granting a permit to Naftogaz and/or its subsidiaries to use subsoil on the continental shelf and exclusive (marine) economic zone of Ukraine for a period of 30 years without auction.

The Government made a decision dated 16.12.2020 that Naftogaz would acquire shares in the authorized capital of Nadra Yuzivska LLC, owned by Nadra Ukrainy NSC (99%) and its subsidiary Ukrainian Geological Research and Production Center (1%) (Edict No 1574-p). Naftogaz received the right to explore and extract hydrocarbons in the Yuzivska area located in Donetsk and Kharkiv oblasts as a result of this acquisition. The Government also approved draft agreements with JSC Ukrgasyodobuvannya on sharing the hydrocarbons to be extracted within Buzivska, Ivanivska, Berezyanska and Balakliyska areas on 28.12.2020 (Edicts No 1647-p, No 1648-p, No 1654-p, No 1655-p). The corresponding agreements were signed on 31.12.2020.

The CMU approved the ownership policy of Naftogaz (Resolution No 982) on 21.10.2020, and approved the Company’s updated Charter with amendments bringing it into line with the Guidelines of the Organization for Economic Cooperation and Development (OECD) on Corporate Governance of State-Owned Enterprises on 26.10.2020 (Resolution No 997). In addition, the CMU agreed on 20.03.2020 with the proposal of the Supervisory Board of Naftogaz to extend the term of powers of A. Kobolyev, the Chairman of the Board of the JS Company, from 23.03.2020 to 22.03.2024 (Edict No 327-p), and the Government approved the decision dated 14.12.2020 to elect Lecroy Bruno Jean Gaston and Clare Mary Joan Spottiswoode as independent members of the Naftogaz Supervisory Board for a period of six months and to extend the term of the civil law agreements concluded with them by entering into additional agreements (Edict No 1562-p).

On 13.04.2020, the Verkhovna Rada set a salary limit for managers and members of supervisory boards of public sector entities in the amount of 10 minimum wages as of 1 January 2020 (Law of Ukraine No 553-IX of 13.04.2020). Pursuant to the requirements of the Law No 553-IX, on 29.04.2020 the CMU set a monthly salary limit over the quarantine period of UAH 47,230 for managers and members of supervisory boards of the entities in the public sector of the economy. Such limits were in effect until September 2020 inclusive and were withdrawn by the CMU’s Resolution No 996 of 26.10.2020.

On 27.05.2020, the CMU improved the procedure for ensuring customs payments when moving natural gas across the customs border of Ukraine via pipeline, in particular for storage under the “Customs Warehouse” regime (Resolution No 415).

On 09.07.2020, the NEURC issued a license to a Naftogaz subsidiary, Energoservice, for the right to carry out economic activities for electricity production within Andriivivka ground mounted photovoltaic power station (99.74 kW) (Resolution No 1268). The regulator established a ‘green’ tariff for the enterprise for electricity produced until 01.01.2030, as well as a surcharge to the ‘green’ tariff for compliance with the level of use of the equipment made in Ukraine.

The Verkhovna Rada of Ukraine adopted the Law No 810-IX on 21.07.2020, which restructured ‘green tariffs’ in accordance with the Memorandum of Understanding signed on 10.06.2020 between the government of Ukraine and renewable energy producers or associations representing their interests.
2. STRATEGY: HOW OUR BUSINESS OPERATES
Over the next five to ten tears, we are determined to achieve Ukraine’s self-sufficiency in terms of natural gas and independence from imports.

GAS PRODUCTION

Ukraine’s energy security and import dependence are directly linked to natural gas production. In this regard, I believe the past ten or maybe even twenty years represent a period of missed opportunities. This has finally changed. The current government broke with the past and mandated Naftogaz with an important set of new licenses and a strong mandate to increase gas production. Over the next five to ten tears, we are determined to achieve Ukraine’s self-sufficiency in terms of natural gas and independence from imports.

On our way towards this goal, we expect to attract foreign partners who will bring capital and expertise to Ukraine. We will prioritize offshore, Black Sea, the Yuzivka area, potential deep reservoirs, and specific production-sharing agreements, as well as partners to join existing fields.

The Yuzivka area and offshore fields are significant new projects on the Naftogaz agenda. We are very excited about the possibilities that these opportunities represent. Seismic studies and exploration drilling will help us to better understand the potential of Ukraine’s resource potential. Geologists globally expect significant growth in Ukraine’s gas production and anticipate Ukraine becoming the owner of the number two natural gas reserves in Europe. Naftogaz will seek to locate and identify those reserves. In terms of new and unconventional resources, Naftogaz will also explore the biofuel market. We consider the bio-fuels market as a natural strength for Ukraine to exploit.

INTERACTION WITH CLIENTS

The introduction of new products is supported by our retail business, where we want to provide new experiences for our customers. After the abolition of Public Service Obligations, customers are now free to choose their energy & services suppliers. We seek to become their ‘Energy Partner of Choice’ to provide them with the most cost-effective offer. It is important for us to consider the energy needs of our customers. Based on these observations, we want to expand the portfolio of propositions by including services like the provision of electricity, installation of solar panels in gardens or on roofs, the improvement of energy efficiency in central heating systems, and more.

Customer orientation is extremely important in the long term. We want to offer a positive experience and stay in touch with 3-4 million households in Ukraine that freely choose Naftogaz as their preferred energy partner.

The energy services market is a novelty for both Naftogaz and Ukraine. We are eager to play our part. We will innovate to build a business oriented on the reduction of energy consumption and greater energy efficiency, which are crucial for all efforts to minimize the country’s dependence on imports.

FINANCING

Initially, we will use our internal funds. As we scale up, we will look to access new funds. We will be glad to attract subsidies and loans from international partners such as the EU or the EBRD. In the medium-term perspective, we do not have sufficient funds for production development. Instead, we will have to turn to financial markets for our investments. We will also seek to involve partners in order to attract the necessary capital to accelerate our growth ambitions.

INTERACTION WITH SOCIETY

Throughout our business activities, we interact closely with regions and communities. When approaching farmers, we seek to provide competitive compensation for the opportunity to use their land. Our activities generate additional jobs for local residents, increasing income and security. Independent research confirms how the Oil & Gas sector in general, and Naftogaz specifically, can become a catalyst and accelerator for economic and job growth in the country. One can observe very specific material results from our activities, such as the construction of new roads, and the expansion of social infrastructure including new schools, hospitals, and sport facilities. In everything we do, we aspire to become model corporate citizens and respectful neighbors. This ambition is driven by our core values: courage, openness, fairness, and conscientiousness. We are motivated to evolve, and this motivation encourages us to innovate. Our overarching principle of delivering exactly what we promise is what makes us a trustworthy energy partner of choice.

CHALLENGES ASSOCIATED WITH STRATEGY

IMPLEMENTATION

We realize that the main obstacle to the implementation of our growth strategy is matching our ambitions with our financial possibilities. We might not be able to access sufficient finance on capital markets. Or our shareholders may require dividends, leaving our investment plans without funds. There are certain geopolitical risks that we all understand. Our ability to raise significant investment and borrow money depends largely on how international financial institutions evaluate Ukraine’s progress and participation in the international market. About half of our investment ambitions must be met by borrowing from the market and through partnerships. Our strategy is not without risks. Continued support from the government and Ukraine’s cooperation with the IMF add to the investment credibility of Ukraine and Naftogaz. Effective corporate governance is a fundamental asset for our business. We count on the government to establish a favorable national environment for borrowing and establish a strong financial framework. We are very hopeful. I share this sense of optimism. In the energy market, the country is demonstrating that Ukraine is moving forward. The government is constantly working to improve our legal and judiciary framework. Rule of law is the cornerstone of all long-term international investment. We see this as essential in order to attract finance and build partnerships.

Otto Waterlander
Chief Operating Officer, Chief Transformation Officer of Naftogaz Group
Corporate strategy

NEW CORPORATE STRATEGY OF NAFTOGAZ GROUP SEES NAFTOGAZ AS ENERGY PARTNER OF CHOICE ON A MISSION TO UNLOCK UKRAINIAN ENERGY MARKETS POTENTIAL

— On 21 January 2021, the Supervisory Board of Naftogaz approved the Corporate Strategy of Naftogaz Group (further – the Strategy) which is grounded on the Ownership Policy and expectations of the State towards the company. The Strategy reflects the Naftogaz vision and ambition to become the Partner of Choice for its key stakeholders and unlock Ukrainian energy markets potential.

— Naftogaz chooses three specific business platforms – Gas Business, B2C/Utility and Low Carbon Businesses – to grow in a sustainable manner and leverage synergies across them. The focus on these three platforms reflects the strategic pivot of the Naftogaz from commodities to customers and from assets to knowledge.

— The Strategy sees Naftogaz Group transformed and ready for IPO by 2025 with key value catalysts being de-risking of its major upstream growth opportunities, successful building of B2C/utility platform, and establishment of low carbon business presence. The success of its strategic effort will result in a doubling of Naftogaz Group value to USD 12-17 billion.

— Energy transition is one of the key focuses of the Strategy, with the ambition to become carbon neutral by 2040 and enter into new energy businesses (e.g., hydrogen, biofuels and carbon capture, utilization and storage).

— Naftogaz Group plans an ambitious investment program, with Exploration and Production investment (its main component) expected to be at least USD 20-25 billion over the next 10 years.

— By successfully delivering on the Strategy, Naftogaz will become the catalyst for economic growth and the well-being of Ukraine. Realizing its exploration and production ambitions will add 273,000 new jobs and result in UAH 441 billion in GDP growth and UAH 791 billion in domestic output growth during the 2021-2030 period.

The Strategy reflects the goal and objectives of the state ownership declared in the Ownership Policy which was adopted on 21 October 2020 and assumes rationale of state ownership to ensure:

— security of gas supply;
— achievement of energy independence, in particular from natural gas imports;
— energy sector transformation and completion of natural gas market reform;
— effective representation and advocacy of Ukraine’s interests at national and international levels, including relations with national oil and gas companies of other countries;
— oil and gas production;
— oil and oil products transportation.

Naftogaz also embraces the objective of preparing and successfully conducting an IPO of Naftogaz Group which is stated in the Ownership Policy.

The Strategy also considers relevant global energy industry trends and outlook for natural gas, renewables, and other industry segments:

— natural gas preserving its position in the global energy mix over the following 20 years;
— natural gas and oil price environment being characterized by high volatility and outlook uncertainty;
— knowledge, digitization, and cost competitiveness being core competitive dimensions that both upstream and downstream energy players focus on;
— energy transition pacing pace as companies pursue their carbon neutrality targets and develop their low carbon business portfolios;
— new green energy products and technologies (e.g. hydrogen, carbon capture, utilization and storage, second generation biofuels etc.) becoming viable and gaining pace, driven by regulation and government support;
— developing and delivering on sustainability/ESG agenda having become the globally recognized sign of the company’s future competitiveness and value creation potential.

Naftogaz is well-positioned to navigate the uncertain future and embrace change when making decisions. Our values – courage, openness, fairness, and conscientiousness – guide us and help us seize new opportunities and take calculated risks while being open and fair, both within and outside of our organization.

THREE BUSINESS PLATFORMS

Naftogaz chooses three specific business platforms to grow in a sustainable manner and leverage synergies across them.

— Naftogaz will grow its Gas Business platform which serves today as the main profit and cash generator for Naftogaz Group and consists of exploration and production, storage, trading, and wholesale operations. The Strategy here includes (1) exploring and developing new growth opportunities in upstream, (2) improving cost and capital efficiency and (3) building out trading capabilities.

— Naftogaz will build its B2C/Utility platform which got the opportunity to develop after the PSD regime was abolished for retail customer supply in August 2020. With early success of growing customer base, building presence, and scaling up platform in 2020, Naftogaz aims to (1) establish low-cost retail model (2) acquire 2-4 million customers and (3) consider expansion to heat supply.

— Naftogaz will establish Low Carbon Business platform to pursue its (1) carbon neutrality 2040 ambition and (2) develop its new energy business options portfolio (including hydrogen, biofuels and carbon capture, utilization, and storage). Focusing on its strategic core businesses will require Naftogaz to rationalise resource allocation to non-core activities and – together with the Shareholder – seek to remove constraints to divest or liquidate non-core businesses.

GAS BUSINESS PLATFORM

Gas Business platform of Naftogaz today is largely centered around exploration and production activities, which generate most of the value for the Group, while trading/wholesale and storage operations play the role of mostly supporting activity. The Strategy in Gas Business focuses on unlocking the potential of new growth opportunities in upstream, building trading capability, and fixing challenges in natural gas sales and supply.

EXPLORATION AND PRODUCTION

Unlocking national resource potential via partnerships, knowledge, and efficiency.

Ukraine is one of Europe’s most promising natural gas resource provinces, being #2 in Europe by reserves and resources after Norway and the United Kingdom, respectively. Over the past 10 years, Ukraine’s oil and gas industry growth has been limited by lack of access and consistency. Limited access to resources, price controls, and slow liberalization and deregulation of upstream activities were some of the key causes behind largely flat production over the past 10 years. In 2020 and Q1 2021, Naftogaz and the Government came close to a breakthrough to change the Exploration and Production (further – E&P) future of the company, as the Government considered Naftogaz to be the Partner of Choice to unlock the nation’s natural resource potential.

The signing of four production-sharing agreements, obtaining access to Yuzovka and Black Sea offshore opportunities, as well as the launching of new exploration areas in the Carpathians allow Naftogaz to increase production potential fivefold (measured as estimated ultimate recovery) from...
Alongside exploration efforts, Naftogaz will strengthen its stewardship of mature portfolio of infant assets. However, in the meantime, Naftogaz faces the challenge of effectively de-risking its existing portfolio, which will require USD 20-25 billion of investment over the next 10 years.

The E&P Strategy will allow Naftogaz to preserve its 2P reserves with a 5-year reserve replacement ratio of 100% and secure sustainability and a path towards energy independence. Exploration and development of new opportunities, together with management of existing portfolio, will require USD 20-25 billion of investment over the next 10 years. In the meantime, Naftogaz faces the challenge of effectively de-risking its portfolio of infant assets.

Alongside exploration efforts, Naftogaz will strengthen its stewardship of mature fields portfolio through four key levers:
- Field focus and accountability (well-based to field-based approach change, dedicated field teams with accountability and resources).
- Modernization of surface infrastructure (booster compressor station modernization, pressure optimization, de-bottlenecking and infrastructure downtime reduction).
- Production digitization (large-scale 3D seismic program, 3D reservoir model development, digitization of well and field information, surface infrastructure and other activities).
- Disciplined cost management (large-scale lifting and other operating cost optimization).

This will be complemented by active production enhancement and mature field revitalization partnership efforts. Naftogaz intends to optimize its brownfield portfolio management approach by identifying fields which are best managed through partnership mechanisms (building on production enhancement partnership that Naftogaz concluded with Romania’s Expert Petroleum in 2020) and conduct fast track partner attraction processes in H2 2021 – H1 2022.

To deliver on its E&P ambition, Naftogaz will focus on three key areas to build capability and enhance competitiveness:

- Introduction of new E&P operating model (implementation of asset-based organizational design with internationally experienced professionals, transformation of R&D capability, introduction of rigorous funnel management and prospect maturation process).
- Cost transformation (operating expense and working capital optimization, capital discipline improvement and ensuring learning curve in new opportunity development).
- Active partnership and financing arrangement (introduction of innovative partnership options for greenfields, e.g. post-exploration farm-in partnerships, and joint bidding for new opportunities).

The exploration success of new growth opportunities will mean unlocking natural gas resource and production potential. Naftogaz ambition is to drive Ukraine to energy independence in gas over a 10-year period.

TRADING AND WHOLESALE

Building customer base, developing trading capability, and securing value. The global natural gas market has been going through high volatility price reality over the past few years, creating high uncertainty regarding future scenarios. In Ukraine, market price uncertainty is further amplified by weather factors and high storage gas stocks balance.

In Ukraine, the natural gas market is undergoing significant changes. With staged abolishment of PSD regime, market price setting mechanisms are now applied for all gas market customer segments, with district heating companies remaining the only PSD category. Integration of Ukraine with the EU gas market has improved liquidity and increased competition, with many players entering or increasing their presence.

Consequently, Naftogaz will adjust its commercial activities focus towards being a customer-centric supplier with competitive value proposition and active risk manager, portfolio optimizer, and trader, securing long-term value for Naftogaz E&P and generating gains through competitive sales and trading activities.

Commercial transformation will require building a new trading organization and infrastructure and developing segment-specific strategies to profitably grow sales and supply volumes, and to ensure improving collections. Naftogaz will rapidly build our trading capabilities to access higher return market opportunities and improve ability to hedge risks. This, in particular, will mean that Naftogaz will have to enter the EU market and adopt European physical and financing trading practices and prepare itself to trade a multiple of the physical volume in financial forward markets with the objective of reaching EU-level churn rate within 5 years.

Successful implementation of the Trading and Wholesale Strategy of Naftogaz Group will mean turnaround of wholesale and trading business and is estimated to result in USD 2 billion of value created for Naftogaz Group.

B2C/UTILITY PLATFORM

Building utility platform, managing growth, and delivering customer value.

The natural gas market fundamentally changed and opened for competition in retail gas supply in August 2020. Naftogaz had long been preparing for this moment and was ready to take full advantage of market changes and the opportunity to expand in the retail segment.

Naftogaz surpassed its own plans for 2020, having increased the customer base to 639 thousand customers (over 2 times the original plan) across the entire country and stepping in as the supplier of last resort (SLR) where existing suppliers could no longer continue fulfilling their obligations.

Market liberalization opened competition and resulted in a wide price offering from suppliers to households. Naftogaz has been among the lowest price suppliers, with its price being almost 30% lower than those at the high end of the market in December 2020.

We believe that our competitive product offering and growing presence will provide superior value to the customer and allow us to ramp up our presence and reach our objective of 2-4 million customers and 30-35% market share by the end of 2025.

To build a truly national presence, we will rely on partnerships, with many online and physical presence partnerships already in place and having proved to be mutually beneficial.

We see 2021 as a crucial year to leverage momentum, ramp up the scale, and build out the low-cost gas utility platform. Getting it right will allow us to extend beyond gas
and move further into developing and providing competitive integrated energy solutions based on our deep knowledge of customer needs and our capabilities.

Delivering on its B2C/utility platform building ambition, Naftogaz shall grow into the energy utility of choice for the Ukrainian customer known for its best-in-the-market competitive value propositions.

LOW CARBON BUSINESS PLATFORM

Pursuing carbon neutrality by 2040 and developing new energy business options Naftogaz will embrace energy transition and will gradually increase investments aiming to become carbon neutral by 2040. It will do so through strategic efforts to lower GHG emissions (including improvement of GHG detection and reporting) and entering into attractive low carbon new businesses. We believe that pursuing carbon neutrality ambitions and investing in a low carbon business platform will prepare us well for transition, serve as another proof of our long-term competitiveness, and focus on sustainability to help us add at least USD 1 billion to the energy utility of choice for the Ukrainian customer known for its best-in-the-market competitive value propositions.

NAFTOGAZ TRANSFORMATION AND VALUE CREATION

Delivering on the Strategy, Naftogaz Group intends to transform itself into a three-platform national champion value story and will become ready for IPO in 4-5 years. This strategic effort has the potential to create USD 12-17 billion in value, which shall come from operational and commercial excellence, fueling growth across the traditional energy industry value chain, and pursuing its low carbon and innovation agenda. Naftogaz aims to become a catalyst for the economic growth and well-being of Ukraine, which is relevant to all stakeholders. Its strategic activities are expected to result in new job creation, partnership opportunities for financial institutions and businesses, employment and growth in prosperity of the Ukrainian people.

PRECONDITIONS FOR NEW STRATEGY SUCCESS

For the new Naftogaz Group Corporate Strategy to be a success, it is important to draw conclusions from past experience, including from the past efforts to transform the national gas industry.

Looking ahead, Naftogaz Group sees the following preconditions to the successful delivery on its Corporate Strategy:

- Continued market reform and staying away from backsliding towards past non-market regulation practices
- Resolution of the regional supply and district heating company indebtedness problem as well as abolition of PSD format in district heating and solution of systemic issues in the heating sector
- Balanced and predictable dividend policy that allows to attract financing and invest in growth
- Continuation of corporate governance in accordance with OECD standards
- Consistent regulatory policy that is clear and reasonable to investors. These preconditions are crucial to enable Naftogaz Group to deliver on its Corporate Strategy and its mission.
NAFTOGAZ AS ENERGY PARTNER OF CHOICE

CONSUMERS: choose reliability and best value

EMPLOYEES: choose opportunities and stability

PARTNERS: choose opportunities, competence, and transparency

STATE: chooses development programs and budget transfers

PEOPLE OF UKRAINE: choose economic growth and well-being

NAFTOGAZ GROUP MISSION AND VISION

Our Corporate Strategy is crystallized in our mission to unlock the full potential of Ukrainian energy markets and provide competitive energy solutions for the benefit of the Ukrainian people and vision and ambition to become the Energy Partner of Choice:

— for customers by being a reliable provider of competitive energy solutions;
— for employees by providing a safe, balanced, and rewarding working environment, equal opportunities, and fair remuneration;
— for partners by initiating and welcoming collaboration and partnership opportunities across the Naftogaz portfolio of businesses;
— for the State by helping drive the national energy agenda and value story;
— for the people of Ukraine by ensuring its activities contribute to national economic growth and well-being.

NAFTOGAZ GROUP RESULTS

Investments into drilling equipment
Managing production decline at mature fields
Partnerships with international players who are ready to work with us today
Production/reserves ratios at the level of global players with similar depletion levels
Exploration & production experts with international experience

JOINT WORK OF NAFTOGAZ GROUP, THE GOVERNMENT, AND THE PARLIAMENT OF UKRAINE

made it possible to effectively address many challenges in 2020

GOVERNMENT OBLIGATIONS

- Awarding permits/providing access to new opportunities (most awarded only by the end of 2020)
- Changes to the Tax Code
- Production Sharing Agreements (PSA) (signed in December 2020)
- From 19 Government action-plan items only 1 was fulfilled in a complete and timely manner

IMPLEMENTATION OF THE CONCEPT OF DEVELOPMENT OF NATURAL GAS PRODUCTION INDUSTRY OF UKRAINE UNTIL 2020

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Exploration and Production division

Management

Deputy Director of Exploration and Development
Sanhar Zharkeshov

Deputy Director of Production
Oleg Tolvachev

Director of Strategic Projects
Maksym Vityk

Chief Engineer
Oleksii Nesterenko

Chief Geologist
Mykhailo Machushak

Heads of branches

Director of Shubelyna Gas Production Division
Yury Fesenko

Director of Potiava Gas Production Division
Andriy Misiunov

Director of LyivGasVydobuvannya Gas Production Division
Serhii Kryvulia

Director of UcrNDIGas Scientific Research Institute
Oleksandr Sendeha

Heads of functions

Director of Director of Exploration and Production Development
Vaclav Chaus

Geology Director
Valentin Lokhiev

Head Of Development
Askar Azanayev

Head of Business Development
Yeorenny Shashchenko

In-house experts

Chief Exploration Expert
Agostino Macagni

Chief Expert of Strategic Projects
Peter Rolfs Taviers

Seismic Survey Manager
Martin Paul Bookholt

Chief Adviser of Strategic Projects
Bryan Scalla

Expert board

Oleksandr Alushyn
Deputy General Director for Research of the Ukrainian Oil and Gas Institute, Doctor of Technical Sciences

Vitaliy Vityk
General Director of RITE «Boura» Technicon, Candidate of Technical Sciences

Mykhailo Vedoroshchuk
Doctor of Geological Sciences

Bohdan Klyuk
Candidate of Technical Sciences

Oleksandr Kondrat
Head of the Department of Oil and Gas Production, Iuuno-Frankivsk National Technical University of Oil and Gas, Doctor of Technical Sciences

Yury Krupsky
Doctor of Geological Sciences, Candidate of Geological and Minedraural Sciences

Sergiy Kurlovets
Vice-Recter for Scientific and Pedagogical Work of Iuuno-Frankivsk National Technical University of Oil and Gas, Doctor of Geological Sciences

Oleksandr Lukin
Academician of the National Academy of Sciences of Ukraine, Doctor of Geological Sciences

Igor Murychko
Geological engineer, academician of NUNS, specialist in the field of oil and gas development

Ilya Rybilchuk
An expert manager in the gas industry, a scientist-inventor in the field of subsiul use

Ilya Fik
Head of the Department of Oil, Gas and Condensate Extraction, NTU «KhPI» and the Department of Geology of KNU named after V.N. Karazin, Doctor of Technical Sciences, Candidate of Geological and Minedraural Sciences
Key results of exploration and production division in 2020:

- The division produced 13.53 bcm of marketable gas (13.45 bcm of which account for JSC Ukrvydobuvannya), which is 2% more than the production plan and 1% less than in 2019. Under the conditions of quarantine restrictions, reduction of the average gas price by 30%, and reduction of investments by 30%, Naftogaz Group by joint efforts minimized the rate of production decline.

- The unit’s EBITDA stood at UAH 27.99 billion with EBITDA margin of 56% respectively.

- Capital expenditures comprised UAH 11.02 billion, which is 50% lower than planned due to implementation of anti-crisis measures to ensure the company’s financial stability.

- As part of the unit’s transformation, a new operational model and organizational structure focused on achieving the strategic goals of increasing resource potential and hydrocarbon production were developed. One of the key changes was the reformatting of geological and production functions according to the asset-focused operating model.

- The unit has strengthened internal expertise of geological, production, and design functions by oil and gas professionals with international experience.

Year of challenges and anti-crisis steps

In 2020, Naftogaz Group, and the Exploration and Production division in particular, faced the necessity of responding to new challenges – the COVID-19 pandemic and maximum uncertainty on the gas market – and simultaneously continue internal transformation.

- Naftogaz Group, in partnership with the State, laid the foundation for increasing the resource base due to gaining access to one of the largest development opportunities in Ukraine, in particular: (1) decision by the Cabinet of Ministers of Ukraine to transfer Black Sea offshore licenses to Naftogaz; (2) purchasing corporate rights for Yuzivka area; (3) signing 4 production-sharing agreements (PSAs).

- In January 2021, the Supervisory Board of NISC Naftogaz of Ukraine reviewed and approved the strategy of the Naftogaz Group until 2025, in particular the strategy and business plan of the Exploration and Production division;

- According to the approved strategy, one of the key-enablers for successful achievement of goals by the Naftogaz Group and the Exploration and Production division in particular is recognition and consolidation of the Company’s status as a reliable and desirable business partner for active and effective cooperation. In first quarter of 2021, Naftogaz Group signed three memorandums of understanding and cooperation with international partners.

at Naftogaz Group. In mid-2020, the team drew up an anti-crisis action plan to significantly reduce costs at low prices, preserve production and jobs, and ensure uninterrupted supply of natural gas to households and industry. Due to this anti-crisis action plan, the Exploration and Production division’s investment program was reduced by 50%, while reduction rates of gas production were minimized.

To ensure this level of production, the division team had to overcome “1.9 bcm of base fund production decline. To compensate, teams from Exploration and Production and Technical divisions conducted the following operations on the base fund and put into operation the following quantity of wells: 178 well workover operations, 486 coiled tubing operations, 41 reperforations and 50 hydro fracking operations. 41 new wells were also put into operation.

In 2020, the Exploration and Production and Technical divisions started full scale cooperation with LLC Haliburton Ukraine (subsidiary of Haliburton, USA) performing sidetrack drilling (13 wells were put in operation) and with LLC Weatherford Ukraine (subsidiary of Weatherford International Ltd., Switzerland) on artificial lift (44 operations conducted). The types of operations performed are relatively new for the Exploration and Production division and required the development of new competencies for careful selection of well-candidates for their successful implementation.

In the reporting year, the division’s team managed to extract 382,000 tons of gas condensate and 66,000 tons of oil and bitumen, which is 6.7% lower compared to 2019, but 10.9% higher than planned.

As one of the steps to optimize production on the existing portfolio of fields, a complex surface infrastructure modernization program was approved, leading to the implementation of the following:

- operating pressure optimization measures, including by installing mini-compressors at complex gas treatment units and construction of pipelines;
- Modernization of booster compressor stations, in particular
Chervonometickiy booster compressor station, which pumps ~13% of the production volume of JSC Ukrgasvydobuvannya; de-bottlenecking of surface infrastructure; new field infrastructure construction and commissioning; measures to ensure natural gas quality.

While implementing a production digitalization program, the division, together with American company Honeywell Internation Inc., installed a system for distant monitoring of highly productive wells, which will help to monitor, control working regimes online, and take effective decisions to correct them instantly if necessary. During the reporting period 48 wells were equipped out of contracted volume of 386 wells, which will be finalized by the end of 2021 according to the plan.

The first steps towards optimizing the management of existing depleted field portfolio performed in 2020, crystallized in the following 4 key levers – directions to focus efforts on in the years ahead:

1. At the date of report issuance, DVGolyer and MacHughton company finalized an audit of reserves and revenue of certain fields with interest attributable to JSC Ukrgasvydobuvannya as of 1 January 2021. According to this audit, the Company’s 2P reserves replacement volume stood at 5.9 bcm, and is the highest for the last 4 years.

Year of strategic initiatives creation to increase resource base

Naftogaz Group Focuses on optimizing production from existing fields while unlocking national resource potential through partnerships, experience and efficiency.

Naftogaz Group has identified a number of key strategic initiatives aimed at dramatically increasing resources, increasing hydrocarbon production, and ensuring the Company’s sustainability. Strategic initiatives cover the exploration and development of conventional resources as well as tight gas deposits in the West, East and South of the country (see Map of Black Sea potential).

DEVELOPMENT OF BLACK SEA POTENTIAL

At the end of 2020, the Cabinet of Ministers of Ukraine adopted a resolution on Amendments to the Procedure for Issuing Special Permits for Subsoil Use, which gave Naftogaz of Ukraine the right to explore and extract oil and gas on the Black Sea shelf. This decision shall help unlock the existing potential of Ukraine’s subsoil, grow the economy, fill the budget, and attract investment. It represents the start of one of the most ambitious projects in the oil and gas industry of Ukraine. In the first quarter of 2021, in pursuance of the decision of the Cabinet of Ministers of Ukraine, the State service of geology and subsoil of Ukraine issued permit for a geological study of the Skifksa area and the Dolphina area to the Naftogaz Group. In the next two years, the division plans to conduct seismic surveys and involve experienced foreign partners in joint exploration and development.

Recent discoveries of oil and gas companies working in Black Sea point to the high probability of finding large gas deposits at areas issued to the Naftogaz Group. So far, for the last decade, growth of hydrocarbon resources and reserves, and more. As a result of these implemented transformations, attracting a new team of specialists with international experience, and coordination with external experts, an updated strategy for the Exploration and Production division was developed, which assumes a significant increase of the resource base and production primarily through the implementation of strategic initiatives with simultaneous optimization and an increase in the economic efficiency of management of the existing portfolio of assets. Worldwide industry standards assume at least twofold excess of resources over reserves, while the current situation is diametrically opposite. The implementation of strategic initiatives will bring the pyramids of resources to industry standards, which will ensure sustainable long-term development of division. An additional important consequence of the successful implementation of the strategy of the Exploration and Production division for the state is the generation of ~ USD 17 bn of net transfers to government for the next 10 years.

In January 2021, the Supervisory Board of NJSC Naftogaz of Ukraine reviewed and approved the strategy of the Naftogaz Group until 2025, in particular the strategy and business plan of the Exploration and Production division, paving the way for the implementation of strategic initiatives.

Map of Black Sea potential
Map of strategic initiatives of Naftogaz Group to increase the resource base
In 2019, Naftogaz Group won the right to conclude four production-sharing agreements: Batalyshka and Ivanivska, Berezyanska, and Buzivska areas, two of which in partnership with Vermilion Energy. In the middle of 2020, Vermilion Energy decided not to proceed with these projects due to changes in their strategy, significant decline in prices for natural gas and oil compared to 2019, the pandemic and global economic recession, which affected Company’s plans regarding participation in projects in new regions.

In December 2020, the official signing of production sharing agreements in four locations took place. Under these agreements, Naftogaz Group undertakes to conduct 3D seismic exploration in the first 5 years in an area of 1.155 thousand square kilometers and 812 exploration wells. The total guaranteed investment should reach USD 120 million. In particular, Naftogaz Group will assume the entire scope of commitments for geological study and development of the Batalyshka and Ivanivska areas, which were previously planned to be shared with a foreign partner.

About the fields under production-sharing agreements

Batalyshka area is situated in Kharkiv region and borders two of the largest by production and 2P reserves fields of NZС Ukrgasvodyobuvannya – Shebelynske and Fmyshnyanske. The area totals 1,119 square kilometers with average well depth of approximately 6,000 meters. According to internal expert estimates, EUR* for portfolio of deep horizons is 37 bcm. First of all, these are perspective deep horizons at existing fields – the largest are Shebelynske, Ko- mysnyanske, Berezyanske, and Krasnikutskoe, with average depth varying from 5 to 7 kilometers. In this initiative, new perspective fields with perspective deposits deeper than 5,000 meters are also considered like Zhemchuhinske, Skydanivske, and Rodniyove. At the beginning of 2021, a new well Zhemchuhinska 1 with initial production rate of 100 tcm/day was put into operation and active drilling performed at Skydanivske area. A significant event was the start of drilling at the Shebelynske 888 well with a design depth of 5,765 meters in December 2019. At the end of 2020, the well drilling phase was completed, and the well is currently being tested. If successful, the well should confirm the potential of deep deposits of the Shebelynske field. In 2021 year additional 11 F&A wells related to this initiative are planned for drilling.

DEVELOPMENT OF YUZIVSKA AREA

Yuzivska area is located in the Dnipropetrovsk region and borders several small fields of NZС Ukrgasvodyobuvannya. The area totals 670 square kilometers with average well depth of approximately 4,000 meters. According to internal expert estimates, the potential EUR of this area is 10.7 bcm of gas. Berezyanska area consists of 4 parts – one is situated in Kharkiv region, while the others are in Lviv region. The area totals 287 square kilometers. Average well depth is approximately 4,000 meters in the East and approximately 2,500 meters on the West. According to internal expert estimates, the potential EUR of this area is 6.7 bcm of gas and 4 m tons of oil.

DEEP HORIZONS DEVELOPMENT

The Exploration and Production division has certain licenses in its portfolio, which, according to the geological and exploration data, possess significant perspectives for industrial and economic development of hydrocarbons at a depth over 5,000 meters. According to internal expert estimates, EUR* for portfolio of deep horizons is 37 bcm. First of all, these are perspective deep horizons at existing fields – the largest are Shebelynske, Ko- mysnyanske, Berezyanske, and Krasnikutskoe, with average depth varying from 5 to 7 kilometers. In this initiative, new perspective fields with perspective deposits deeper than 5,000 meters are also considered like Zhemchuhinske, Skydanivske, and Rodniyove. At the beginning of 2021, a new well Zhemchuhinska 1 with initial production rate of 100 tcm/day was put into operation and active drilling performed at Skydanivske area. A significant event was the start of drilling at the Shebelynske 888 well with a design depth of 5,765 meters in December 2019. At the end of 2020, the well drilling phase was completed, and the well is currently being tested. If successful, the well should confirm the potential of deep deposits of the Shebelynske field. In 2021 year additional 11 F&A wells related to this initiative are planned for drilling.

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EXPLORATION OF CARPATHIAN POTENTIAL

The Carpathian region is a complicated asset for geological studies and exploration, first of all due to complex mountain conditions.
The significant part of the Exploration and Production division’s strategy is to attract experienced international partners for joint investment and efficient and rapid development of sites.

First steps for potential partnerships were taken already in 2021:
1. In February 2021, Naftogaz Group signed a memorandum of understanding on cooperation with the leading integrated energy company in Southeast Europe-Romanian OMV Petrom, and with the largest Polish state-owned company, PGNiG, for joint geological exploration to select promising areas and further cooperation through production-sharing mechanisms. In 2021, the division plans, together with partners, to study in detail the geological potential and the possibility of further cost-effective development of the region.

The abovementioned strategic initiatives are poorly studied and insufficiently researched, and therefore, according to preliminary estimates, their successful implementation will require investments of USD 20-25 bn over the next 10 years - USD 17.3 bn of which is investment in the development and of the region.

PEC contract and handed over for management 13 fields with company Expert Petroleum. From 1 October 2020 Expert Petroleum - was the signing of the first agreement in the history of Przemysl fields by 2.5 times) gives cause for optimism in the example, based on 3D seismic studies, PGNiG increased resources and the remoteness of oil & gas infrastructure. Nevertheless, the positive experience of Poland in exploration of this region (for depletion as of 01.01.2020, %

Since 2016, Naftogaz Group has been actively working on attracting partners to increase the efficiency of operations on depleted fields and on new fields. Pursuant to activities to increase the efficiency of work on depleted fields, an important achievement of 2020 that should be noted was the signing of the first agreement in the history of the oil and gas industry of Ukraine to increase production (production enhancement contract) with the Romanian company Expert Petroleum. From 1 October 2020 Expert Petroleum was granted access to fields within the perimeter of the PEC contract and handed over for management 13 fields with available infrastructure (13 surface infrastructure facilities)

served by 147 employees. In general, after concluding the agreement, 42% of hydrocarbon production of GPJ Livizgayzydobyvannya (a branch of JSC Ukrgayzydobuvannya) is managed by Expert Petroleum.

For the three months of 2020, Expert Petroleum managed to conduct 8 well workover operations, resulting in additional average production on these wells increased by 100 tcm/day. In the first half of 2021, Naftogaz Group plans to conduct a detailed analysis of the existing field fund and select candidates for future partnerships, considering various forms of partnership and combinations of field selection depending on the results of the analysis and interest of potential partners.

The brands – OMV and Petrom. OMV Petrom is a valuable and reputable partner with investment potential, knowledge and relevant experience in the region.

About Naphtha Israel Petroleum
Naphtha Israel Petroleum Corporation Ltd. is an Israeli company listed on the Tel Aviv Stock Exchange. Through its subsidiaries, Naphtha explores and develops oil and gas deposits and produces hydrocarbons on US onshore and the Israeli shelf. It has a majority stake in the costs of development and operation of the large Tamar gas field with a capacity of approximately 370 bcm, located on the Israeli shelf, opened in 2009. From the beginning of production in 2013 and until 2020, the volume of commercial gas from the Tamar field amounted to approximately 66 bcm, which was supplied mainly to the domestic market of Israel.

About PGNiG
PGNiG SA, is one of the largest companies traded on the Warsaw stock exchange.
Naftogaz Group views attraction of experienced foreign partners as an efficient method for search and development of strategic initiatives and strategy implementation in general, thus sets the goal of becoming a partner of choice. Existing partnerships demonstrate that the synergy of experience and modern technologies has a positive impact on the production and financial results of Naftogaz Group.

The internal transformation and transparency of Naftogaz Group in partnership mechanisms is a demonstration of the Company’s reliability to potential partners, which aims to serve as a basis for realization of strategic initiatives and sustainable development using all opportunities to ensure the energy efficiency of the country.

For Naftogaz Group: PJSC Ukrnafta, NJSC Naftogaz of Ukraine, PJSC Ukrgasvydobuvannya
For Naftogaz Group assets in AR of Egypt: NJSC Naftogaz of Ukraine Branch in Arab Republic of Egypt
For Ukrnafta: Report as of April 1, 2019 on Reserves and Revenue and Contingent Resources of Certain Properties with Interests Attributable to PJSC Ukrnafta in Ukraine PRMS Case by Deloitte and Mathieson Limited
For Ukrgasvydobuvannya: Report as of January 1, 2021 on Reserves and Revenue of Certain Properties with Interests Attributable to JSC Ukrgasvydobuvannya in Ukraine PRMS Case (for proved and probable reserves) by Deloitte and Mathieson Limited
For Naftogaz: PJSC Ukrgasvydobuvannya, NJSC Naftogaz of Ukraine, PJSC Ukrgasvydobuvannya NJSC Naftogaz of Ukraine Branch in Arab Republic of Egypt

The geographical breakdown of natural gas production by JSC Ukrgasvydobuvannya in 2020, mcm

<table>
<thead>
<tr>
<th>Region</th>
<th>Production</th>
<th>Condensate</th>
<th>Gas in barrels</th>
<th>Condensate in barrels</th>
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<tbody>
<tr>
<td>Zakarpattia</td>
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<td>-</td>
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<tr>
<td>Ivano-Frankivsk</td>
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<td>-</td>
<td>-</td>
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<td>Luhansk</td>
<td>45</td>
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### HYDROCARBON RESERVES AND RESOURCES OF NAFTOGAZ GROUP

<table>
<thead>
<tr>
<th>Group/Entity</th>
<th>Proven Reserves</th>
<th>Probable Reserves</th>
<th>Natural Gas (mmbbls)</th>
<th>Oil and gas condensate (mmt)</th>
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<tbody>
<tr>
<td>Ukrnafta PJSC</td>
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<td>Naftogaz Group</td>
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</table>

Source:
For Naftogaz Group: PJSC Ukrnafta, PJSC Ukrgasvydobuvannya PJSC Naftogaz of Ukraine (in Russian): Oil and Gas in barrels, Oil and gas condensate in metric tons. For Naftogaz Group assets in AR of Egypt: NJSC Naftogaz of Ukraine Branch in Arab Republic of Egypt Estimated Future Reserves, Resources and Income Attributable to Certain Interests and Certain Interests in a Concession Agreement (escalated parameters) as of December 31, 2020 by Ryder Scott Company L.P.
For PRMS audited reserves and resources, ratios to convert volumes of liquid hydrocarbons from metric tons into barrels, as well as ratios to convert natural gas volume from cubic meters into barrels of oil equivalent were identified by auditors according physical properties of hydrocarbons fluids. For Ukrgasvydobuvannya, ratios of 6,000 cubic feet of gas per barrel of oil equivalent is used for conversion purposes. For Ukrnafta, 7.30 ratios is used to convert barrels of oil equivalent into barrels of condensate.
JSC Ukrgasvydobuvannya fields that account for more than 2/3 of total production

Western oil and gas region

Scale 1:500,000

- Production in 2020, bcm
- Remaining reserves as of 31.12.2020, bcm
- % produced to date out of original reserves
- JSC Ukrgasvydobuvannya's largest fields
- New exploration permits in 2014-2020
- Borders of Dnieper-Donets basin

Eastern oil and gas region

Scale 1:400,000

1 Gas deposits deeper than 5,000 m
2 For calculation of field depletion levels for 31 December 2020, remaining 2P reserves as of end of 2020 calculated as 2P reserves based on PRMS methodology from the report of DeGolyer and MacNaughton from 1 January 2021.

GCF - gas and condensate field
OGCF - oil, gas & condensate field

Source: Naftogaz Group
Trading division

KEY TRADING DIVISION RESULTS:

— In 2020, Naftogaz sales to the commercial segment that comprises industry (including “Gas Transmission System Operator of Ukraine” LLC (TSO of Ukraine) and UEEX traded volume, grew almost twofold from 3.0 bcm in 2019 to 5.8 bcm in 2020. The Naftogaz market share in the commercial segment increased from 28% in 2019 to 30% in 2020.
— Due to introduction of new products (e.g. quarterly products, post-payment conditions), Naftogaz dramatically increased the volume traded at UEEX. In 2020, Naftogaz gas sales at UEEX were 1,160 mcm, which corresponds to an over nine-time increase versus the 2019 level of 123 mcm.
— Naftogaz won more than 80% of all tenders announced by the TSO of Ukraine during 2020. This allowed Naftogaz to supply 3.6 bcm to the TSO of Ukraine in 2020.
— In Q4 2020, for the first time in the company’s history, Naftogaz directed its sales abroad, exporting 246 mcm.
— Due to introduction of new products (e.g. quarterly products, post-payment conditions), Naftogaz dramatically increased the supply companies (RSCs), and district heating companies (DHCS). The Trading division sells and supplies gas to its customers under direct contracts as well as those sold at trading platforms. Naftogaz Group has become a major force behind the development of natural gas platform trading, namely at the Ukrainian Energy Exchange (further – UEEX).

2020 was a year of significant progress in natural gas market liberalization. This started with the introduction of market pricing for household and district heating company supply from 1 January, 2020, and was followed by the abolition of PSD in the retail segment. Coupled with Ukraine’s further integration with the EU gas market and abundant imports and storage capacity, these developments have stimulated market liquidity and competition. Many players have entered or increased their presence in the market. Increasing activity and competition required Naftogaz to adjust its commercial activities to those changes and transform its commercial organization to secure long-term value for Naftogaz Group gas production and generate additional value through competitive sales and trading activities. Naftogaz Group seeks to build a commercial organization which combines customer focused supplier, risk manager, and portfolio optimizer capabilities.

To achieve this vision, Naftogaz made the decision to split Integrated Gas into Exploration & Production and Commerce divisions in the spring of 2020. At the end of 2020, the Trading and Retail Business divisions were created from the Commerce division to further sharpen managerial focus and build out specialized organizations and capabilities for the two businesses.

Today, the Trading division includes the activities of Naftogaz Group related to imports, sales, trading, and wholesale supply of natural gas. Trading’s counter-parties include large industry players, the Transmission System Operator (TSO), regional gas supply companies (RSCs), and district heating companies (DHCS). The Trading division sells and supplies gas to its customers under direct contracts as well as those sold at trading platforms. Naftogaz Group has become a major force behind the development of natural gas platform trading, namely at the Ukrainian Energy Exchange (further – UEEX). 2020 was marked by an expansion of sales trading activity at UEEX by Naftogaz. Naftogaz trading volumes at UEEX expanded nearly from 123 mcm in 2019 to 1,160 mcm in 2020. This was due to two key initiatives implemented by the Trading division in order to be more agile and to improve the value proposition in accordance with customer needs and the market situation. First, Naftogaz adopted a new more responsive and flexible price-setting methodology which allowed Naftogaz to faster react to market movements and reflect this in its pricing. This gave a boost to traded volumes starting from May 2020. Later in the year, Naftogaz introduced a series of new products and other value proposition enhancements. Quarterly products allowed for the purchase of natural gas at a fixed price with supply in Q4 2020 and Q1 2021. Another new feature was the introduction of post-payment terms in UEEX with collateral from a

Volumes sold through UEEX

1,160 MCM

Naftogaz trading volumes at UEEX in 2020

1 2 3
Supplies to TSO

80% Naftogaz succeeded in winning about 80% of overall volumes in 2020

Naftogaz supplied 3.6 bcm to the TSO of Ukraine in 2020

counter-party in the form of a bank guarantee. Additionally, in February 2021, Naftogaz increased the post-payment period for its UEEX trading offering from 30 to 45 days.

Offering post-payment conditions was a reaction to frequent requests coming from traders that regularly experienced liquidity shortages. Naftogaz product innovation and better financial terms are a reflection of Naftogaz’s ambition to be the partner of choice to market participants and offer them the offering they value most. The value of these propositions resulted in a significant increase in traded volumes in Q4 2020.

Furthermore, in 2020, Naftogaz Trading has significantly increased its sales to the direct industry segment with sales rising by 280 mcm, contributing to the growth of market share to industrial segment (excluding TSO of Ukraine) to 5%. Similar to the UEEX trading ramp-up, this result was possible due to better and more agile pricing methodology adopted by Naftogaz Group. This increase is also partially attributable to higher sales in the summer period when the price level was attractive for electricity generation companies.

In terms of sales volume, TSO of Ukraine stands out as the biggest industrial customer of Naftogaz Group. Through 2020, TSO of Ukraine conducted four auctions to purchase natural gas for a total amount of 4.96 bcm, with a supply period from March 2020 to April 2021. While all these auctions were quite competitive, Naftogaz succeeded in winning about 80% of overall volumes, which allowed the company to sell 3.6 bcm of natural gas in 2020 with a further 0.4 bcm to be supplied in 2021. This competition and the volume of auctions resulted in the creation a liquid price indicator, which became one of the main benchmarks for price setting in the local market.

2020 saw a change in Naftogaz relations and sales to RSCs and the Regional Gas Company Group (RGC) in particular. The abolition of the PSO regime in the retail supply segment starting from August 1, 2020, triggered most RSCs and RGC to stop buying natural gas from Naftogaz.

While Naftogaz offered them the opportunity to conclude annual supply contracts, RSCs were not ready to switch to the new market realities from the past conditions of Naftogaz obligation to supply, post-payment terms, and lack of consequences for low payment discipline. As a result, the Naftogaz share in the portfolio of RSCs decreased from 82% in 2019 to 45% in 2020 or, in terms of sales volume, from 7.8 bcm in 2019 to 3.7 bcm in 2020.

While many RSCs stopped purchasing gas from Naftogaz following PSO abolition, most of the registered gas sales decrease resulted from RSC companies stopping procurement of gas from Naftogaz in August-December 2020. Sales volume to RGC companies dropped by 57% in 2020 vs. 2019. In August-December 2020, RGC companies procured no natural gas from Naftogaz.

However, when price regulation was implemented for Q1 2021 and the market witnessed problems with resources, many RSCs returned to Naftogaz as a gas bank on the market.

While natural gas supply by Naftogaz to district heating companies (DHCs) grew to 8.1 bcm in 2020 versus 7.4 bcm in 2019, the sector still suffers from legacy problems and weak payment discipline.

The PSO regime for DHC supply is due to be cancelled on May 1, 2021. Naftogaz is ready to work with the Government and other key stakeholders in the heating sector to develop solutions and set on a path to sustainability.

To manage its trading operations and risks, Naftogaz Trading division implemented the ETRM system. This is an industry-wide standard to ensure control and manage all types of trading risks. ETRM is an important infrastructure foundation for Naftogaz Group trading control framework which encompasses trading mandates, counter-party risk management, and price risk management.
Natural Gas Storage Division

KEY RESULTS IN 2020

1. Total volume of gas injected into underground storage facilities (UGS) was 12.7 bcm (3% less than the previous year). Total volume of gas withdrawn from gas storage facilities was 7.9 bcm (4% less than the previous year).

2. As of the end of 2020, 8.6 bcm of gas was stored in the “Customs Warehouse” regime. Of this, storage by non-residents was 7.7 bcm, which is 3.8 times higher than in 2019.

3. As of 2020 injection season, Ukrainian UGS had accumulated 28.3 bcm of gas*, which is 30% higher than the previous year and the highest in the last decade.

4. Net revenue of the Natural Gas Storage segment in 2020 was UAH 1.1 billion, which is 58% higher than the previous year. This increase was mainly due to strong customer demand and the introduction of “short haul” transmission tariffs in early 2020.

5. EBITDA of the Natural Gas Storage segment in 2020 was approximately UAH 3.3 billion, which is 67% higher than the previous year.

6. The operating cash flow of the Natural Gas Storage segment in 2020 was UAH 3.9 billion, four times higher than in 2019 (UAH 1 billion).

In the course of internal transformation of the Storage System Operator (SSO) and introduction of the new Ukrtransgaz organizational structure in 2020, the updated structure of the Natural Gas Storage Division includes Ukrtransgaz headquarters and production structural units. The Natural Gas Storage Division includes 12 UGS facilities in mainland Ukraine, taking into account the Verkhunove UGS that, as of 2010 year-end, was in the part of Luhansk region that is temporarily occupied territory of Ukraine.

After the unification of natural gas transportation activities, 2020 was the first year for Ukrtransgaz as an independent SSO, providing natural gas storage services to both Ukrainian and foreign clients. As of 2020, Ukraine almost quadrupled the volume of gas held by non-residents. SSO ended 2020 having had contractual relations with 848 companies (at the beginning of 2020—651 companies).

The number of non-resident clients doubled during the year to 90 companies from 24 countries. By comparison, in early 2020, representatives of 14 countries stored their gas in Ukraine. This change was facilitated by competitive gas storage tariffs and the special “short haul” gas transportation tariff. Another factor was growing confidence among the international community in SSO due to systemic reforms and the implementation of unbundling.

KEY DRIVERS OF THE RECORD VOLUMES OF NATURAL GAS IN UNDERGROUND STORAGE FACILITIES

The increase in the attractiveness of Ukrainian gas storage facilities in the EU gas market was due to a number of market factors as well as the effective work of SSO during 2020.

1. The market factors include as follows:
   1. High filling level of the EU UGS facilities (high gas reserves formed due to the uncertainty of further transit at the end of 2019, warm winter of 2019/2020).
   2. Lack of gas storage capacity in EU countries.
   3. Falling gas prices and growing demand for storage services from traders.
   4. Decrease in gas consumption during the economic downturn caused by the COVID-19 outbreak.

In addition to favorable market conditions, the record level of gas volume in Ukrainian UGS was directly influenced by the activities of the independent SSO, in particular:

1. Successful completion of unbundling as a strong evidence that Ukraine complies with the requirements of the EU gas market.

2. Development of a commercial function focused on cooperation with non-resident customers.

3. Creation of new products, in particular “Customs Warehouse” + “Short haul”.

4. Increasing the consistency and transparency of interaction with clients (KYC, publication of free capacities, etc.).

5. Digitalization of clients service.

VALUE CREATION FOR CUSTOMERS

“Customs Warehouse” service

In 2017, Ukrtransgaz implemented a natural gas storage service known as the “Customs Warehouse” regime. Service allows traders to store natural gas in underground gas storage facilities for 1095 days without paying any taxes and fees, subject to further transportation of natural gas from the territory of Ukraine or its placement in another customs regime. Initially, customers showed moderate interest in this service, but in 2019 interest began to grow – customers placed over 8.1 bcm of natural gas in the UGS, and in 2020 the injected volume of natural gas in customs warehouse was 10.2 bcm.

Improving consistency and transparency

During 2020, SSO maintained a constant dialogue with its clients, resulting in increased transparency and quality of work and the introduction of new services. Since August 2020, SSO publishes daily updates online of free capacity at gas storage facilities. In addition, a function for monitoring free capacity of gas injection and withdrawal for the current and next days was added to SSO information platform. With this new service, customers of gas storage services can view updated information on free gas injection and withdrawal capacities in their personal account 24/7. The free capacity monitoring function introduced by Ukrtransgaz improved the transparency of gas storage management processes in accordance with international standards.

Service of “Monitoring over the pledged natural gas in storage”

In 2020, SSO expanded its portfolio of services and to provide the customers with the related services, in addition to the conventional ones: natural gas storage, injection and withdrawal. In particular, in late 2020, SSO introduced another service “Monitoring over the pledged natural gas in storage”. This service enabled the banks to monitor transactions with natural gas in the UGS, which customers use as collateral for loans. Monitoring is carried out online 24/7 using SSO information platform.

Banks benefit most from monitoring natural gas stored in the UGS due to significantly reduced credit risk. This in turn enables clients to receive the necessary funding on more favourable terms.

OPERATIONAL EFFICIENCY IMPROVEMENT

Organisational structure

The major task after unbundling was to establish the independent SSO. Accordingly, systematic review of business processes and updating of functions were required.

In 2020, the organisational changes took place as a result of which the number of management levels was reduced from three to two. The structure of the technical department and the commercial department was completely restructured, which facilitated the efficiency grow, as well as improved the quality of gas storage services. This restructuring of the subdivisions was undertaken with a focus on a two-tier management structure. Total Ukrtransgaz staff was reduced by 20%. The Natural Gas Storage Business Division was optimised by 6%. At the beginning of 2021, the Division headcount was 1.7 thousand FTEs.

KEY DIRECTIONS OF GAS STORAGE DIVISION DEVELOPMENT

Interaction with the Ukrainian Energy Exchange

In February 2021, Ukrtransgaz and the Ukrainian Energy Exchange signed an agreement on cooperation, which provides for the provision of customers of storage services (injection, withdrawal) of exchange standardized products for trade in natural gas stored in underground storage facilities. The new functionality will allow companies to speed up and optimize gas trading operations, increase their reliability, and help attract a wider range of participants to bidding. It is expected that the project will be implemented in two stages. The first stage opens the possibility for participants of the gas market of Ukraine to conduct trade operations with customs-cleaned natural gas stored in gas storage facilities through the platform of the Ukrainian Energy Exchange. At this stage, resident companies working with customs-cleaned gas have access to exchange trading. At the same time, SSO acts as a guarantor of the availability of the amount of gas declared for bidding in the underground storage facility and provides automation of its transfer from one bidder to another. After that, the Exchange conducts clearing operations in cooperation with the bank.
2) The second stage of the project opens the possibility of trading in gas through the platform of the Ukrainian Energy Exchange and for customers who store gas in underground gas storage facilities of Ukraine in the "Customs Warehouse" and "Customs Warehouse + short haul" modes. Thus, the service becomes available, also to non-resident companies.

Tariffs change of gas storage (injection/withdrawal) services

On June 24, 2020, the NEURC approved tariffs for natural gas storage (injection, withdrawal) services in underground gas storage facilities, effective as of July 1, 2020. The set tariffs also apply to the "Customs Warehouse" service. Tariffs were calculated by the "Cost+" method approved by the NEURC Resolution No. 1131 dated 13 June 2016. Due to the Regulator policy, the nominal (to the "cost+" method approved by the NEURC Resolution No. 1131) tariff for the "Customs Warehouse" service. Tariffswere calculated by the "Cost+" method approved by the NEURC Resolution No. 1131 dated 13 June 2016. Due to the Regulator policy, the nominal (to the "cost+" method approved by the NEURC Resolution No. 1131) tariff for the "Customs Warehouse" service. Tariffswere calculated by the "Cost+" method approved by the NEURC Resolution No. 1131 dated 13 June 2016. Due to the Regulator policy, the nominal (to the "cost+" method approved by the NEURC Resolution No. 1131) tariff for the "Customs Warehouse" service. Tariffswere calculated by the "Cost+" method approved by the NEURC Resolution No. 1131 dated 13 June 2016. Due to the Regulator policy, the nominal (to the "cost+" method approved by the NEURC Resolution No. 1131) tariff for the "Customs Warehouse" service. Tariffswere calculated by the "Cost+" method approved by the NEURC Resolution No. 1131 dated 13 June 2016. Due to the Regulator policy, the nominal (to the "cost+" method approved by the NEURC Resolution No. 1131) tariff for the "Customs Warehouse" service. Tariffswere calculated by the "Cost+" method approved by the NEURC Resolution No. 1131 dated 13 June 2016. Due to the Regulator policy, the nominal (to the "cost+" method approved by the NEURC Resolution No. 1131) tariff for the "Customs Warehouse" service. Tariffswere calculated by the "Cost+" method approved by the NEURC Resolution No. 1131 dated 13 June 2016. Due to the Regulator policy, the nominal (to the "cost+" method approved by the NEURC Resolution No. 1131) tariff for the "Customs Warehouse" service. Tariffswere calculated by the "Cost+" method approved by the NEURC Resolution No. 1131 dated 13 June 2016. Due to the Regulator policy, the nominal (to the "cost+" method approved by the NEURC Resolution No. 1131) tariff for the "Customs Warehouse" service.

CHANGEOVER TO GAS METERING IN ENERGY UNITS PURSUANT TO THE EUROPEAN STANDARDS

In order to improve the customer-oriented focus and meet the demand of the European customers, SSO began testing a software package in 2020 to automatically collect and analyze data from natural gas volume and quality metering instruments in energy units (kWh). The software package is an internal product designed by the Institute of Gas Transport, which is a part of Naftogaz Group. Once this software package enters commercial operation, Ukrainian gas storage facilities will be ready for the next stage of integration with the EU gas market, i.e. interconnection of the gas metering system from cubic meters to kWh. Additionally, state-of-art gas metering points with flow chromatographs and moisture meters will be installed during 2021-2025 at nine Ukrainian storage facilities. In line with the Gas Storage Network Code, gas metering points should be installed at the UGS and GTS connection points. This will make it possible to track qualitative and physicochemical characteristics of natural gas online, and to account it both in physical and energy units.

At the legislative level, a compromise was reached in discussions with the National Commission for State Regulation of Energy and Public Utilities; the Verkhovna Rada Committee on Energy, Housing and Utilities Services; the American Chamber of Commerce in Ukraine and the European Business Association regarding the usage of the conversion factor when converting gas accounting from cubic meters into energy units that corresponds to the higher heating value of natural gas combustion of 10.595 kWh/m³ (Draft Law of Ukraine No. 2553 pending its second reading). The Entity submitted proposals to the subcommittee on Gas, Gas Transportation, and Gas Supply Policy of the Verkhovna Rada Committee on Energy, Housing and Utilities Services.

IMPROVEMENT OF UGS CUSTOMERS INTERACTION – ENHANCED IT PLATFORM FUNCTIONALITY

Due to an increase in the number of customers storing gas in Ukrainian underground storage facilities, the process of automating and simplifying the administration of natural gas storage is a key priority for the Operator. In 2020, the IT platform significantly improved interaction with UGS clients, substantially improving the efficiency of existing processes. Work is continuing to expand the functionality of the IT platform for greater interaction with UGS clients. Since January 2021, SSO has implemented a new functionality to carry over advance payments for storage services. Using the IT platform in the personal account, customers of services have the opportunity to independently manage their funds and carry over advances in payment from one service to another. The system automatically informs the customer of the results of such advance carryovers.

Another achievement was the expanded functionality of applications for additional custom declarations. This function became available in the personal accounts of IT platform services customers as early as March this year. It is implemented in terms of the automated selection of the numbers of relevant periodic and additional customs declarations, using the calculation of bid gas volumes.

Another improvement was the introduction in March 2021 of an automated separate record of gas in the UGS under different customs regimes. As part of this function, differentiation by consignees in the relevant "Customs Warehouse" and "short haul" regimes was carried out, which, in turn, enables the client to track its gas consignments and residues in a more convenient way.
Naftogaz Group
Annual report 2020

IT-platform functionality

Register/database
- Customer registers for gas storage services and natural gas storage contracts
- UGS List with periodic customs declarations synchronization with information platform of Gas Storage Code
- Downloading of gas reducens on customer accounts
- Generation of notifications as per Gas Storage Network Code

Storage System Operator account
- Capacity allocation
- Record of credits, encumbrances and enforcement of judicial decisions
- Certificates on gas flow in gas storage facilities on customer accounts
- Administration of change in customs regime
- "Hourly calculation of free technical capacity of gas storage facilities"
- Calculation of free capacity of gas storage facilities as a step ahead
- Physical Gas Balance Project
- Free capacity verification

Customer account
- Calculation of NTS (Needs for Proposals) to switch over from storage regime with "Customs Warehouse" and "Short Lead" types of storage regime "main warehouse" or "Customs Warehouse"
- Capacity booking
- Change of volumes of security gas stock
- Change in capacity with limitations
- Change in capacity with limitations
- Customer payments between services
- Creation of a new exchange-based profile

Nomination
- Nominations/nominations
- Functional flow scheduling (data management for verification "matching" for UGS party)
- Trade notifications
- Verification of nominations/verifications with "Customs Warehouse" and "Short Lead" inside and the residual amount as per FCO

Allocation
- Obtaining actual data of gas injection/withdrawal volumes as per underground storage facilities
- Downloading physical dataset injection/s/withdrawal from UGS
- Change of allocation based on the results of nominations/CO (Customs Union) verification
- Verification of trade notifications with "Customs Warehouse" and "Customs Warehouse-Short Lead" modes

Customs Warehouse
- Maintenance of additional CO (customs declarations)
- Customer warehouse clearance
- Capacity with limited "shorthaul" in "Customs Warehouse-Short Lead" regime
- Records of gas with "Customs Warehouse" and "Short Lead" types as consignments
- Change (addition/deletion) of consignments (notifications with "Customs Warehouse" and "Short Lead" modes)
- Gas remaining for switching in "Customs Warehouse" mode

General
- Creating platform user profile
- Integration with existing ERP to obtain service payment status, contract synchronization of contracts, debits, application for the transfer of gas capacity
- IT platform communication tools
- Brief reports
- Variations of the customer’s account
- Display of spare capacity, capacity allocation, gas transfer trade notifications

UGS development plan for 2020-2029, UAH million
According to NEURC Resolution №1151 of 24.06.2020 (amended)

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<th>Location</th>
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<td>Solokhivske</td>
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</tr>
</tbody>
</table>

13.5 UAH Billion
Investments 2020-2029
Heat Energy Business Division

**Key Operating Results of Heat Energy Business Division**

- Net revenue of Heat Energy Business Division in 2020 amounted to UAH 137.2 million.
- Heat production in 2020 reached 163.2 thousand Gcal.
- Useful heat output reached 99.2 thousand Gcal.
- Electricity generation in 2020 amounted to 12.0 thousand MWh.
- Over the period of September-December 2020, the total volume of provided electricity distribution services reached 35.6 thousand MWh.

**Heat Energy Business Division was established in October 2020** and combines heat production and electricity generation activities, as well as function of a distribution system operator. The perimeter of Heat Energy Business Division includes Naftogaz Teplo, which includes the following branches: CHP Novoyavorivsk, CHP Novyi Rozdil, Novoyavorivsk power grids and Novyi Rozdil power grids.

**CHP Novoyavorivsk**

- Installed thermal capacity: 52 MW
- Installed electricity capacity: 149 Gcal/h
- Length of thermal networks: 24 km
- Length of power grids: 192 km

**CHP Novyi Rozdil**

- Installed thermal capacity: 24 MW
- Installed electricity capacity: 32 MW
- Length of thermal networks: 32 km
- Length of power grids: 77 km

**Heat Production and Heat Output**

- Heat production – 163 thousand Gcal;
- Useful heat output – 99 thousand Gcal;
- Electricity generation – 12 thousand MWh.

**Key Performance Results of Distribution System Operators**

- Distribution system operators are Naftogaz Teplo LLC in Novoyavorivsk and Novyi Rozdil CHPs for 2021. The distribution system operators also include the following branches: CHP Novoyavorivsk, CHP Novyi Rozdil, Novoyavorivsk power grids and Novyi Rozdil power grids.

**Key Indicators and Events at the Heat Energy Business Division**

- Heat production – 163 thousand Gcal
- Electric energy production – 12 thousand MWh
- Useful heat output – 99 thousand Gcal
- Electric energy generation – 12 thousand MWh

**Major Events**

- Naftogaz Teplo LLC was appointed the manager of the thermal power plants in Novoyavorivsk and Novyi Rozdil CHPs.
- A license on distribution of electric energy was obtained, tariffs for distribution were approved by NEURC.
- The High Anti-Corruption Court of Ukraine resolved to transfer the assets of PPC Energogaz-Novoyavorivsk LLC and Energogaz-Novyi Rozdil LLC as single property compliance by selling them to ARMA.
EXTERNAL ROADBLOCKS TO THE BUSINESS DIVISION DEVELOPMENT

Assets are not transferred to ownership

- Assets under management contracts with the National Agency of Ukraine for finding, tracing, and management of assets derived from corruption and other crimes (Asset Recovery and Management Agency, the ARMA) have not been transferred to the ownership of Naftogaz Teplo LLC, which affected its business activity by restricting the company’s actions in terms of financing of capital investments and upgrades of production assets.

In line with the rulings of the High Anti-Corruption Court of Ukraine (the “HACC”), it was resolved to refuse to transfer the Assets of SPC Energia-Novoyavorivsk LLC and Energia-Novyi Rozdil LLC as single property complexes by selling them to ARMA. In addition, Kyiv Commercial Court is considering cases based on the claim of SPC Energia-Novoyavorivsk LLC an Energia-Novyi Rozdil LLC against ARMA and Naftogaz Teplo LLC on invalidation of property (assets) management agreements of 19 November 2019 and of 11 February 2020 entered into between Naftogaz Teplo LLC and ARMA.

As of the date of this report, there has been no court ruling on invalidation of property management agreements. If the ruling is made in favor of the claimant, the management agreements are terminated, there is a threat to Naftogaz Teplo’s participation in the development of the heat energy market in the regions of licensed operations of Novoyavorivsk and Novyi Rozdil CHPs.

Establishing cooperation with communities on joint social development programs and development of economically reasonable tariffs

The tariff for heat generation for Novoyavorivsk and Novyi Rozdil CHPs is subject to approval by the NEURC, and the tariffs for transportation and supply of heat are approved by local governments. Currently, the tariffs for heat and hot water supply approved in November 2019 are still in force for residents of Novoyavorivsk and Novyi Rozdil. At the end of 2020, the company followed the legal procedure to submit a package of documents to the local authorities to review and establish 2021 final consumer tariffs for heat and hot water in order to bring them to an economically justified level.

To ensure that the interests of all participants in the process of providing and consuming heat energy services are taken into account, a working group of representatives of Naftogaz Teplo, Novyi Rozdil City Council and local deputies was set up.

The company continues to support urban communities not only by paying taxes to the local budget, but also by involving representatives of urban communities in common social and infrastructure projects within the framework of the Development Energy Grant Competition, which is held by Naftogaz Group.
**Technical division**

**KEY RESULTS OF TECHNICAL DIVISION IN 2020:**
- Commercial drilling speed with own rigs increased by 59% (from 488 m/month in 2019 to 778 m/month in 2020)
- Implementation of new technologies and methods for production intensification. In particular, use of artificial lift, new technologies with coiled tubing units, and hydraulic fracturing technologies with a higher intensity of viscous fluid injection, etc.
- Modernization of production capacities: new drilling and workover rigs put into operation, modernization of existing rigs, contract for purchase of cementing fleet signed, agreement for purchase of live-floors signed, etc.
- The division actively conducted reconstruction of compressor stations Bar and Yagotyn as part of Ukraine’s gas transporting system modernization. Planned to be finalized in 2021-2022
- Maintaining and further development of strategic partnership relations with “Big Four” oil & gas service companies, including full-scale launch of strategic partnership with Halliburton Ukraine (subsidiary of Halliburton, the USA) on sidetrack drilling services and LLC Schlumberger Ukraine (subsidiary of Schlumberger Limited, the USA) on providing supporting services during well drilling under MSA contract
- New projects on creating joint ventures with international partners for providing services.

**Increasing operational efficiency**

2020 was a year of continued internal transformation of Naftogaz Group’s service competences to create a status of reliable and competitive contractor.

The significant depletion of Naftogaz Group’s gas fields, the COVID-19 pandemic, uncertainty in the natural gas market, and internal transformation have posed new challenges to the Technical division, much like the whole of Naftogaz Group, in 2020. The most critical change in the division’s activities was a 50% reduction in the investment program as one of the measures of Naftogaz Group’s anti-crisis plan. Despite all these factors, the division’s team was fully focused on improving the efficiency of operations and development of new technologies in close cooperation with the Exploration and Production division.

1. **DRILLING PRODUCTION, EXPLORATION AND APPRAISAL WELLS**

Completion of a project putting into operation 20 new rigs that started in 2018, together with increasing the competence of drilling crews, made it possible to increase the average commercial speed of the division’s own-drilling fleet by 59% in 2020, from 488 m/month to 778 m/month. Such progress in efficiency has been achieved by increasing the level of competences and experience, because drilling operations are performed exclusively by in-house drilling fleet without the involvement of a third party contractor starting from June 2020. As a result, during 2020, the division completed and delivered 41 wells to the customer (6 of which were drilled by an external drilling contractor), 6 of which are high-flow with a total flow rate of 1.4 million cubic meters/day (№15 at Bugaivske field, №208 and №206 at Berezivske field, №73 at Gadyatske field, №57 and №58 at Komyshnyanske field).

A set of measures to increase efficiency together with optimizing the number of staff from 5240 to 3500 in BU Ulkerbangaz, the service drilling branch of Ukrgasvydobuvannya, during 2020 has created additional reserves for further overheads savings.

In 2020, the Technical division team continued implementation of new technologies and projects that are unique for Ukrainian oil and gas industry including:
- started drilling well №112 at Svyatogirske tight gas field with a depth of 5,335 meters;
- finalized drilling well №888 at Shebelynske field with a depth of 5,765 meters using the own’s Honghua drilling rig in partnership with LLC Schumberger Ukraine (subsidiary of Schumberger Limited, the USA);
- introduction of controlled pressure drilling technology (first time in Ukraine);
- directional well №109 at Tymofiivske field drilled with 4,670 meters wellbore depth and 1,211 meters shift from well mouth (Ukrainian record);
- subhorizontal well №87 at Strilkove field (client – Chornomornaftogaz) with 550 meters depth, 508 meters shift and 886 meters wellbore depth drilled with simultaneous online gamma logging;
- continued active implementation of Peloton’s software “Drilling” module, enabling full control over gathering, analysis, and visualization of data through well life cycle.

2. **WELL WORKOVER OPERATIONS**

In 2020, the Technical division conducted 290 well workover and preventive repair projects, including 178 aimed at increasing production of hydrocarbons and 7 preventative repair operations to support base well fund. The rest were conducted as supportive operations within other projects. To fulfill the production plan, 71 operations out of 290 were performed with outsourced rigs.

Among the operations aimed at increasing production of hydrocarbons, 57 projects assumed workovers with fishing, which are complex and highly risky, in partnership with LLC Weatherford Ukraine (subsidiary of Weatherford International Ltd., Switzerland) that provided high quality fishing tools and percussive mechanisms;
- for the first time in the history of Ukrvydobuvannya JSC, in partnership with LLC Weatherford Ukraine, drilled pipes threads for well workover were repaired. During 2020, approximately 900 drill pipes were repaired using new technologies such as cold root rolling.

In 2020, the division actively worked on implementing the following changes to increase the efficiency of well workover operations:
- a unit of engineering and technological support to manage technological operations during well workover operations and reduce non-productive time created on the basis of UGV-Service – the service branch of Ukrvydobuvannya JSC.

A significant event for the division is completion of fishing works at one of the deepest wells of the Naftogaz Group, №629 at Komysyannyske field with a depth of 6,070 meters, which was put into operation with a flow rate of more than 300 thousand cubic meters per day after well service operations.

At the same time, the division actively worked on expanding its own production capacities for well workover services:
- 5 new workover rigs with a capacity of 125 tons were put into operation: rigs include the latest hydraulic blow out preventers, which will reduce the time for sealing the well in the event of gas and oil showings. During 2020, these rigs conducted 6 workover operations;
- signing of loan agreement with the European Bank for Reconstruction and Development for EUR 51.85 mln, that will be used mainly to purchase 10 workover rigs;
- 30 living camps were renewed (20 for drilling crews and 10 for service crews) to improve living conditions of staff and ensure HSE standards;
- concluded an agreement with Applied Oil Tools Gotco and a lease agreement with LLC Weatherford Ukraine (subsidiary of Weatherford International Ltd., Switzerland) that provided high quality fishing tools and percussive mechanisms;
- for the first time in the history of Ukrvydobuvannya JSC, in partnership with LLC Weatherford Ukraine, drilled pipes threads for well workover were repaired. During 2020, approximately 900 drill pipes were repaired using new technologies such as cold root rolling.

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3. COILED TUBING OPERATIONS

During 2020, the division conducted 710 coiled tubing operations, including 486 operations performed to increase or maintain the base level of natural gas production, and 224 performed as supportive operations within other projects. The division’s teams performed 399 operations by using 7 coiled tubing units, while 311 operations required involving 11 outsourced units.

In 2020, for the first time in Naftogaz Group, new technologies and methods for production intensification were introduced:

- nitrogen hydro-sandblasting perforation on coiled tubing in a well with reduced formation precision;
- works with velocity string technology (installing flexible pipe in the well to receive industrial flow of hydrocarbons), providing daily addition of 28 tons of oil (before performing this operation well №17 at Novotroitske field didn’t work);
- new practice of installing cement bridges on the wells in Western Ukraine using coiled tubing units. As a result, daily additional gas production on the well №135 at Pvolno-Mazovske field reached 12 thousand cubic meters, which is quite substantial for wells in this region.

4. HYDRO FRACTURING OPERATIONS

In 2020, the division conducted 93 hydro fracturing operations and 2 testing operations. This included 33 operations performed with the division’s fleet (including testing operations) and 62 operations by outsource contractors – Tacosan Services S.R.L and Service Oil LLC. 63 hydro fracturing operations were performed on the existing base well fund, 25 operations after drilling, and 5 operations after sidetrack drilling. 50 wells were launched as a result of hydro fracturing operations conducted at the existing well fund in 2020.

Among the key results of the fracturing program in 2020 the following should be noted:

- first full-scale hydro fracking was performed by the division’s fleet at deep wells in Poltava region (2 hydro fracturing operations on the wells of Shchiro-Poltavskoe field);
- quantity of operations using the division’s fleet increased by 32% (33 operations in 2020 compared to 25 in 2019).

Depending on well conditions, hydro fracturing operations were performed based on two technologies: with the use of gel systems and fracturing operations by pumping viscous fluids with a friction reducer (HVFR systems) using 2-3 times higher pumping intensity (so-called SlickWater technology).

5. GEOPHYSICAL SERVICES OPERATIONS

In 2020, 2,156 operations were conducted, including over 150 operations in wells deeper than 5,500 meters. The division put into operation the following equipment, which will significantly increase the efficiency of operations:

- GeoWell equipment to conduct logging in open wellbore, ensuring the possibility of operations at temperatures of 175°C and pressure of 1,160 АТМ, as well as in closed wellbore, providing improvements in determining the technical condition of casings and tubings;
- mechanical clamp strap (Hunting), making it possible to define the sticking point of tubing or drilling equipment with an accuracy of 1 meter;
- truck crane for perforation and geophysical work under pressure using blow out preventers.

6. ARTIFICIAL LIFTING OPERATIONS

The artificial lift gas production project was launched in 2019 and is one of the brightest examples of synergies in the areas of production increase. During 2020, 44 capillary systems were installed – systems of thin tubes for the supply of chemical reagents (surfactants) to the well at the bottom, which contribute to the removal of fluid from the well – resulting in an average increase of flow rate at these wells by 24%. Additionally, one system was installed in well №37 at Vahlyhivske field, a piston system that is installed inside the tubing and mechanically prevents the formation of slugs in the tubing. The plunger system was installed at a depth of 5,148 meters, which is a European record. Installation of this system resulted in an increase of the average wells flow rate by 23% (7.5 thousand cubic meters of gas and 4.3 tons of condensate per month). Apart from this, 5 previously installed systems were complemented with installations for pumping the demulsifier. The operating parameters of the installed equipment are monitored by Foreside software of Weatherford International Ltd.

Establishing supply chain management function

2020 saw the launching of a centralized supply chain management function, which assumes an integrated approach to managing data on raw materials, goods, and services to meet the needs of all participants in full.

In 2020, a complete transformation of Naftogaz Group’s supply chain management was launched within the Technical division, including the development of a reliable demand management system (implementation of a demand management model, development of integrated planning), optimization of warehouse and inventory management (consolidation of warehouse, implementation of digital solutions), and improving fleet and logistics management (centralization of fleet management, balanced use of contract fleet, etc.), and the introduction of best practices in category management (development of procurement strategies for key categories and cost-based approach to category management).

To improve supply chain management competence, a team of specialists with significant experience in both national and international companies was formed, which during the reporting period has achieved significant success in the following areas:

- Implementation of new business model

As part of Naftogaz Group’s warehousing transformation, a model of warehouse management based on regional clusters has been developed. This model provides for centralized management of warehouses of various legal entities of the Group (primarily Ukrtransgaz JSC, Ukrgasvydobuvannya JSC and Ukrtransnafta JSC), located in one geographical region. The plan envisages that the warehouse of one enterprise will provide services of transshipment and storage of inventory to other enterprises of the Group. In 2020, the implementation of this model began on the basis of Ukrgasvydobuvannya JSC, which made it possible to reduce warehouse space by more than 30,000 square meters as a result of the optimization of 21 warehouses. Operating costs were reduced and capital investments were focused at key warehouses (regional logistics centers).

- Optimization of warehouse operations

The transformation and further reduction of storage space is set to continue in 2021, in parallel with increasing the efficiency and controllability of warehouses that remain in the system. For this purpose, the logistical zoning of warehouses was developed, a project to equip all regional centers with video surveillance and electronic access systems was launched, and preparations for the implementation of a digital warehouse management system (WMS) began. These initiatives are planned to be implemented in 2021 and the first quarter of 2022.

- Inventory optimization

In 2020, the work was done to optimize stocks of obsolete inventory, including drilling equipment of the Soviet period, which cannot be used due to physical wear. This work will continue in 2021, with a focus on optimizing stocks of pipe products, which not only account for a significant share of cost structure, but are also a critical element for project implementation and maintenance of oil and gas infrastructure. In the future, the ERP system will implement functionality that will digitize and automate the process of supply chain management, from planning of needs in materials and up to supply & inventory management.

- Demand management

In 2020, a prototype of the model for calculating the need for materials for procurement purposes was developed and implementation of this model in the ERP began.
Rebooting capital projects management competence

2020 became the year of reforming Naftogaz Group capital projects management to optimize financial, labor, and time resources.

The Technical division manages the implementation of approximately 90% of Naftogaz Group’s capital projects, which account for most of the Group’s entire investment program. The creation of effective competence for capital projects management is a cornerstone of the division’s work as a whole. In 2020, the transformation of technical competencies and the operational model for capital projects management at the Group level began, primarily in order to manage the full cycle of strategic projects, and a decision to implement integrated project management with a focus on personal responsibility and accountability was made.

In addition, the division has joined forces of all subsidiaries of Naftogaz Group in managing capital projects. An example of this is the involvement of the Directorate for Construction and Reconstruction of the gas transmission system from Ukrtransgaz in the implementation of projects for the construction of Chervonodonetsk BCS and Yablunivska BCS at all stages of work. During 2020, the division actively worked on the standardization of business processes in the management of capital projects. Drafts of standard technical solutions for the capital construction projects of Naftogaz Group were created. The key objectives of implementing a catalog of standard technical solutions are:

— application of modern materials, technologies and design solutions of leading global and domestic manufacturers to improve the reliability and efficiency of technological processes;
— reduction of design terms and overall term of project execution;
— increase of technological units operation reliability due to unification of technical decisions based on best industry practices;
— design documentation quality management.

In 2020, the division implemented a number of critically important capital projects for Naftogaz Group:

**Well connection program**
43 wells were connected (107.4 kilometers of gas pipeline built) and 9 disconnection projects were performed (45.5 kilometers of gas pipeline built).

In order to accelerate the timing of construction and installation works on the connection of wells, starting from 2020, the division’s own contracting construction branch (UBMR Ukrgazspetsbudmontazh) began using the large-node assembly of pipe billets for connecting the wells according to design documents received from customers. Production of large nodes and painting is performed on the production bases of the branch. Introduction of this method of work organization is planned for 2021.

**Construction of complex gas treatment units (UKPG)** and gas pipelines.
With the help of its own construction branch, the division connected the first three wells of the Svyatogirske field and constructed a complex gas treatment unit (UKPG) with a maximum daily capacity of 1 million cubic meters of gas, as well as a 26 kilometer long gas pipeline connection from the Svyatogirske field to the main gas pipeline Shebelynka-Slovyansk.

**Construction/reconstruction program for booster compressor stations (BCS)**
In the reporting year, as part of a project with the European Investment Bank, the unit launched BCS Pasichna (Phase 1) featuring three ARIEL compressors, through which 25% of gas extracted by Ugrikasvodyobuvannya in the Western region is pumped. One significant achievement during 2020 in the field of design and management of capital projects was the creation of a 3D model for the construction site BCS Pasichna (footprint project). Technical support of the gas transmission system and underground gas storage

Key projects by the Technical division for Ukrtransgaz included works to support the functioning of the gas transmission system and underground gas storage facilities. Among the projects implemented in 2020, the following are particularly worthy of note:

— Reconstruction of Bar compressor station, which is a part of Ukrainian gas transit system modernization efforts begun in February 2018. The general contractor for the project is the leading German engineering company DG Industries GmbH (formerly Ferrostaal Industrieanlagen GmbH). Reconstruction will improve the energy efficiency of the compressor station as well as interrepair time increase. Emissions will meet the latest European standards. The efficiency of gas pumping units is expected to increase from 25% to 30%, and annual fuel gas savings are estimated at about 76 million cubic meters. Commissioning of the station is planned for 2021.
— Reconstruction of Zagotovny compressor station. The reconstruction of the compressor station is determined by the urgent need to increase the safety of gas transportation and significantly improve the economic performance of gas transit. Reconstruction works started in 2019. The general contractor is state enterprise MAV Zorya-Mashproekt. Reconstruction of Zagotovny compressor station envisages: the installation of a new station with installation of 4 new gas pumping units (GH-16-16C357-3.7MV) of block-container design with a gas turbine engine and a centrifugal supercharger with a heat recovery unit. New GHPs provide the efficiency of the gas turbine engine (according to ISO conditions) of not lower than 35% and provide CO and NOx emissions to the level: CO— not more than 100 mg/normal cubic meter; NOx— not more than 75 mg/normal cubic meter.

Using Autodesk Revit software. This software is a specialized solution for the design and parameters calculation for buildings and structures. The key features allow users to issue design documentation, perform calculations, model operations, and provide ample opportunities for collaboration between the designer, contractor and customer. Also in 2020, major infrastructure projects were implemented with a planned commissioning date in 2021-2022. These included reconstruction of Chervonodonetsk BCS, Yablunivka BCS, Khrestyshchenska BCS, etc. During the implementation of Chervonodonetsk and Yablunivka BCS reconstruction projects, equipment was used in a block design, which saved time, labor, and investment resources with high productivity and reliability.
Address of Retail Business Division Director

Last year saw the launch of the Ukrainian retail gas market. The signal for the launch was the abolition of the PSD regime. Naftogaz Group sees great potential for the development of the retail market and intends to become an active player in the retail sector. Key factors in retail competition will include not only pricing but also the ability of the supplier to provide comprehensive services and solutions. At this stage, about a third of all customers are already prepared to choose a supplier who would issue an integrated energy bill that includes electricity, gas, and heat. Our task is therefore to become a multi-service product company.

The modern retail market places very high requirements on suppliers. Offering a competitively priced product requires minimizing costs throughout the supply chain. In 2020, we began automating and digitalizing all our business processes. The expertise of Naftogaz Digital Technologies (NDT), the Naftogaz IT subsidiary and other divisions of Naftogaz Group have provided great support in this challenge.

Our business model does not involve building up an own physical customer service center network. Due to the transition to online and efficient work with partners, we optimized operating costs without any deterioration in the quality of service. In 2021, we plan to expand our partner network and increase the number of offline customer interaction points to 4,000 to better serve our customers.

The Group’s expertise in wholesale gas trading also helps to optimize our costs and processes. With our operating model, we cancel our customers some of the best prices for products while selling gas to end customers, both households and legal entities, without intermediaries.

With further development of the market, a customer’s bill will depend not only on price but also on using multiservice products. We are well aware that with the development of the market and competition, the price will cease to be a driver in the struggle for customers, with the emphasis shifting to the quality of services and new products of interest to consumers. The Retail Business Division has therefore launched a range of initiatives including energy efficiency projects. The energy bill is not only about price; it is also about the amount of resources consumed. By offering our customers our energy-efficient products and programs, we help them reduce consumption and, consequently, optimize their utility costs.

One of the most important indicators of our work today is the level of customer satisfaction with services. We build a customer-friendly system at all stages of a contact with the company, and successfully develop self-service channels such as personal account, chatbot, IVR. At present, over 60% of households are ready and willing to work with a supplier online, and recognize the benefits of digital tools. All services are available online now. A full range of services are already available online: account creation, payment, obtaining certificates, history of settlements, and much more. Naftogaz of Ukraine has established a strong marketing department that identifies the needs of our customers and offers new product ideas. As a result, customer satisfaction improved by 10% (from 67% to 77%) and loyalty by more than 50 percentage points (up to 69%) by the end of 2020. Our benchmarks are attractive prices, extended product portfolio, solutions to lower consumption through energy efficiency projects, and, finally, a satisfied customer. Our business is always about customers.

Last year, we started with a portfolio of 250,000 households. Today, we have more than 900,000 commercial customers. At the beginning of January 2021, we reached the level of 10-12 thousand applications from new customers per day. At this stage, we are a national energy service provider; there is no region in Ukraine where we are not represented by at least ten thousand customers. And we will have many more customers soon!

Surveys show that the main reason why people are cautious to change their historic supplier is uncertainty over whether the new supplier is reliable. This means that reliability is not only an advantage, but also a tactic. Here we have sound grounds to move forward; we are part of a large and stable market-leading company, state-owned Naftogaz Group.

Our plans are ambitious: by 2025, we aim to have at least 2.8 million retail customers. An extremely important and difficult job lies ahead. Based on the current dynamics, we believe our ambitious objectives are realistic and achievable!

Maxim Rabinovych
Director, Retail Business Division

“Our benchmarks are attractive prices, extended product portfolio, solutions to lower consumption through energy efficiency projects, and, finally, a satisfied customer. Our business is always about customers.”
Retail business division

On August 1, 2020, Ukraine abandoned the PSD regime and natural gas retail supply market liberalization finally took place. This allowed household customers to choose the preferred gas supplier based on its price offers and service advantages. Suppliers, from their side, are now free to set the price and compete for customers.

Abolition of the PSD regime in the retail segment meant that Naftogaz Group no longer had the obligation to sell natural gas to RSCs for further supply to household customers. As a result, Naftogaz lost its share in the supply of natural gas resources to RSCs, as some of them stayed away from procuring natural gas from Naftogaz Group. The Naftogaz share of household supply (direct and via RSCs) declined from 83% in 2019 to 43% in 2020, making it necessary to build direct retail supply business to secure domestic volume.

In December 2020, a few months into the operation of the free gas market and with retail customer portfolio and supply volumes growing fast, Naftogaz Group created the new Retail Business Division to focus on building a B2C/utility platform and Naftogaz retail franchise.

KEY RETAIL BUSINESS DIVISION RESULTS:

- As a result, the Naftogaz Retail Business market share grew from 2% in 2019 to 9% in 2020, while sales volumes grew by more than 50% from 197 mcm in 2019 to 306 mcm in 2020.
- Today, the Naftogaz Retail Business has national presence, having outperformed its own plans in terms of customer growth by over 100% in 2020. Starting from the launch of the free market, Naftogaz has also acted as SLR, a status GSC “Naftogaz of Ukraine” LLC won via a competition conducted earlier in 2020.

As SLR, Naftogaz’ retail subsidiary ensures natural gas supply to households where local suppliers failed to continue operations and provide customers with gas. This situation first occurred in Donetsk region in October 2020, and later SLR services were used by customers in Kherson and Poltava regions, the city of Kremenchuk in Ternopil region, and the city of Melitopol in Zaporizhzhia region. Serving as the SLR, Naftogaz provided security of supply for residential consumers. Satisfied by the quality of the service and price offering, many households supplied under SLR conditions then converted to become customers of the Naftogaz retail business. As of March 31, 2021, 437 thousand customers in the Naftogaz portfolio came from those households which Naftogaz had supplied in an SLR capacity.

This national expansion was possible due to the active roll-out of partnership programs undertaken by the Retail Business Division team. In order to quickly...
build a national presence and build efficient low-cost operations, Naftogaz pursued partnerships with top banks – PrivatBank, Oschadbank, PUMB. High brand recognition, trust, wide physical presence across Ukraine, and existing online channels allowed Naftogaz to leverage its partners’ capabilities in acquiring new clients. At the same time, Naftogaz customers represented an attractive prospective clientele for Naftogaz’s partners. The Ukrainian customer thus benefited from both the easy application procedure and lower gas price Naftogaz of Ukraine Gas Supply Company LLC can offer due to reduced operating costs resulting in optimized gas mark-up.

From the very beginning, Naftogaz aimed to consistently offer one of the best prices to the Ukrainian customer. In August-December 2020, Naftogaz remained among the most competitively-priced suppliers on the market, while the incumbent suppliers offered prices which were 40% higher on average than the offer of Naftogaz.

In addition to providing beneficial prices to customers, Naftogaz launched a fixed price yearly tariff in August 2020 to address the potential customer need to hedge price risks over a 12-month period. The company offered this product alongside a monthly tariff product. Clients who selected the yearly tariff in August 2020 paid 25% lower than the monthly price by November. The August 2020 annual fixed tariff of UAH 4.73/m3 was 32% lower than the regulated sales price of UAH 6.99/m3 (including VAT) adopted in February 2021 by the government.

Going forward, Naftogaz will continue to focus on preserving and expanding its effective low-cost model, ensuring best prices and high quality of service for customers through pursuing three key strategic directions – digitization, cost efficiency, and energy efficiency.

These efforts – together with launching a new retail brand and conducting a marketing campaign – will put Naftogaz on track to deliver on its ambition to reach a 35% market share and grow its portfolio to 2-4 million customers by 2025.

**Customers**

2.5 times increase in customer base from 251 thousand households on 1 August, 2020, to 619 thousand households by the end of 2020 (and 901 thousand customers as of 31 March, 2021)

**2020 natural gas retail supply competitive price landscape**

(Price range for households in Aug-Dec 2020; UAH/cub. m (incl. VAT))

<table>
<thead>
<tr>
<th>Month</th>
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<th>Min price</th>
<th>GSC “Naftogaz of Ukraine” price</th>
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<tr>
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<td>Dec</td>
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</table>

**Naftogaz Retail Business competitive advantage pillars**

1. **DIGITALIZATION**

   - Easy-to-use online services
   - Easy to change supplier

2. **COST OPTIMIZATION**

   - Trading network

3. **ENERGY EFFICIENCY PROJECTS**

   - Lower consumption
Address of the Advisor to the CEO

European leaders have embraced the terms energy transition and the Green Deal as common policies. They continue to be the main topic of discussion in expected and unexpected places in political, business and civil society circles. These ideas, which are mainstream in Europe, are only beginning to be fully explored in Ukraine, where history has demonstrated it takes longer to turn words into action.

Naftogaz Group tackles daily challenges to ensure Ukraine’s social, political, economic and environmental well-being. At the same time, as a responsible company, Naftogaz Group must continue to think years ahead and prepare for emerging issues and opportunities. With this in mind, we have set the goal of achieving carbon neutrality by 2040, including by increasing our renewable energy business portfolio. This is indeed an ambitious goal for the company. We must not only transform Naftogaz Group into a modern and efficient company, but we must also plan for Naftogaz Group to become a platform for the development of new businesses and sectors that do not currently exist or are fully developed, either in Ukraine or elsewhere in Europe.

We have identified the full integration of our domestic business policies with the European Green Deal as a prospective area of company development. Side-by-side with the best European experts, we have developed a green strategy with clear goals and objectives.

Naftogaz Group operates in an industry associated with high emissions, and the company is aware of our own responsibility in that regard. Naftogaz Group is already working to reduce carbon emissions in our operations. We have analyzed a number of options, from constant upgrades of our technological park to large-scale changes in our operations. Together with our partners from the European Bank for Reconstruction and Development, we have conducted the first studies on methane emissions at compressor stations and gas pipelines leading from our wells to the national gas network. We are now working on a package of detailed recommendations on how to reduce methane leaks and how to improve the efficiency of our networks. These activities are becoming an important source of methane and carbon emission reductions.

We are carefully studying opportunities and weighing the prospects of the European Hydrogen Strategy to pursue the establishment of internal and external clusters of cooperation. We understand that the technological and management solutions that have already been used by our European partners are a roadmap for success; we do not seek to reinvent the wheel.

Hydrogen, like the entire spectrum of its production, transportation, and use is still an uncharted area in many ways, particularly for companies seeking to diversify or transition, creating both significant risks and large opportunities. For many years to come, only big, resourceful and technologically capable companies will be able to implement the kind of large-scale projects that Europe is discussing within the framework of the Green Deal. The companies that succeed will be those able to take necessary risks and have a sufficient level of resources and margin of financial security to go through the difficulties and problems associated with the first stage of the development of the new technology.

History shows that there will be difficulties and problems on the way to pursuing new business sectors. As a result, Naftogaz Group’s new vision includes broad cooperation with the state and with Western partners at the legislative, research, and industrial levels. At the same time, the development of hydrogen energy cannot be considered in isolation from other renewable energy sources, such as wind, biomass, green ammonia, and carbon capture (including the development of technologies for the capture and storage of carbon in underground storage).

Black Sea offshore wind development is an interesting sector and high potential. Based on research by the World Bank and our colleagues from Denmark, we are in active dialogue with experts in leading European, American and Asian countries to explore the most effective ways to implement offshore projects. At the same time, Naftogaz Group is looking for additional financial resources to support the effective introduction of offshore wind farms in Ukraine. Our country currently lacks such financial instruments at a time when offshore wind farms are the focus of attention all over the world. European experts consider the Black Sea to be a viable and attractive platform for the development of offshore wind farms. Naftogaz Group is already implementing several pilot wind power generation projects, both offshore and onshore.

Naftogaz Group is ready and committed to becoming the partner of choice – a most willing and reliable partner – for foreign investment in Ukraine’s renewable energy sector. We recognize that Naftogaz Group should use its resources in the most efficient way to benefit Ukraine. Naftogaz Group should drive technological and business innovations to set the tone for leading Ukraine’s energy transition. The Green Deal for Ukraine, and, in many respects, for Eastern Europe as a whole, depends on our capacity to change and be successful in the new environment. Therefore, the company has a full and robust common agenda to pursue together with the Government, the parliament, and our international partners.

“Naftogaz Group is ready and committed to... becoming the main – and most comfortable and reliable – partner for foreign investment in Ukraine’s renewable energy. We recognize that we should use of the Group’s resources in the most efficient way for the benefit of Ukraine”

Olena Zerkal
Advisor to CEO
New Energy

At the end of 2019, the New Energy Division was established within Naftogaz Group. The division has launched several pilot projects in sustainable energy generation and energy use, including:

1. In June 2020, the construction of the photovoltaic plant (FPP) «Andriyivka» (Kharkiv region) with a capacity of 0.995 MW.
2. In September 2020, the construction of the “Chudniv FPP” (Zhytomyr region) with an electric capacity of 33 MW.
3. The completion of the initial stage of the wind metering campaign, enabling a transition to the next step in the implementation of the pilot project, the Maryivka wind farms construction project (capacity of 20 MW).
4. The completion of the construction of two meteorological towers and the installation of wind measuring equipment, enabling a large-scale transition to a more powerful wind farm as part of the Berezivka wind farms construction project (capacity of 50 MW), including the start of a wind measurement campaign.
5. Pilot projects in retail service for charging electric cars (3 pilot electric charging stations for electric cars installed in Kyiv).
6. Analysis of wind generation potential on the Ukrainian shelf of the Black Sea, including opportunities for green hydrogen production.

Remaining Challenges in Renewable Energy

At present, the following regulatory and commercial aspects of Renewable Energy Sector (RES) implementation in Ukraine need to be addressed:

1. Lack of a functioning auction process for green energy.
2. Instability and delays in payments to RES producers by the Guaranteed Buyer for the produced electricity.
3. Loss of confidence of international investors and rising interest rates on loans from international banks for RES projects.
4. Lack of Ukrainian regulations for offshore projects.
5. Uncertainty regarding tariffs for electricity generation by shunting stations.

Despite the imperfections and uncertainties of the RES and alternative energy market, low-carbon businesses are considered by Naftogaz Group to be a key strategic direction for the future of the company.
Oil Midstream and Downstream division

**THE MAIN FOCUS AREAS OF THE OIL DIVISION TEAM IN 2020 WERE:**

1. In Oil Midstream segment – maintaining current positions. In particular, this meant oil transit through the Druzhba oil pipeline, developing a new direction Odesa – Brody, searching for new customers to load positions. In particular, this meant oil transit through the system in the direction to Belarus, and increasing the volume of transportation in Ukraine.

2. In Oil Downstream segment – formation of an optimal portfolio of refining assets that will be efficient and create added value for the Oil Division, diagnostics of operating refining assets, processing strategic initiatives for the development of refining and commercial functions (oil products trading).

**Oil and liquified gas transit and transportation activities**

In 2020 the volume of oil transit through the territory of Ukraine amounted to 13.2 million tons, which is 0.2% more than in 2019. Domestic oil transportation increased by 9% to 2.6 million tons in 2020, compared to 2.4 million tons in 2019.

**OIL TRANSIT TO THE REPUBLIC OF BELARUS**

Prevision of oil transportation services to the Republic of Belarus takes place under an agreement between Ukrtransnafta and Belneft (Belarus) Limited (Great Britain), which is a subsidiary of CSIC Belarusian Oil Company. During 2020, within the framework of the agreement with BNIK (UK) Limited, Ukrtransnafta accepted ten oil tankers with 886 thousand tons volume at Pivdennyi SOT. Ensuring the transit of oil to Mosyj Oil Refinery made it possible to increase the loading level of Ukraine’s oil transportation system. The Oil Division is working to ensure the continuation of transit to Belarus in 2021.

**FIRST TIME TRANSPORTATION OF WTI OIL**

On 7 June 2020, Ukrtransnafta transported ‘light Texas’ oil – West Texas Intermediate (WTI) for the first time. After checking the quality, the Company began accepting WTI oil for further transportation at the Kremenchuk refinery. This is the fifth brand of oil transported by Ukrtransnafta (incl Bakken Crude Oil and El Sharara Crude Oil).

**RESOLVING THE PROBLEM OF LOW-QUALITY OIL ENTERING THE UKRTRANSAFTA OIL PIPELINE SYSTEM**

On 1 January 2020, Ukrtransnafta completed the displacement of Russian oil with high content of organochlorine compounds from the Ukrainian section of the Druzhba oil pipeline to the Slovak-Ukrainian border, and 21 January, to the Rudnichne oil delivery point (Slovakia).

During the displacement of this contaminated Russian oil, Ukrtransnafta, together with the international surveying company SGS, checked the quality of oil coming from Russia on a daily basis. No repeat cases of contaminated raw materials were recorded. At the same time, after the above events, its operators have improved the quality of raw materials to prevent possible recurrences in the future. In particular, Ukrtransnafta has fully implemented interaction with Belarusian, Slovak, and Hungarian parties and automatically receives information from oil metering unit quality parameters. In addition, Ukrtransnafta has equipped a specialized laboratory of international standard at Brody MOSS. This equipment makes it possible to quickly determine the concentration of organochlorine in oil.

Over the entire period of displacing the low-quality Russian oil from the Ukrainian section of the Druzhba pipeline, PJSC Transneft booked production capacity of Ukrtransnafta and paid EUR 4,336.2 thousand in compensation for booking services from May 2019 to January 2020.

**TRADING OPERATIONS FOR THE PURCHASE AND SALE OF CRUDE OIL**

In spring 2020, during the initial active spread of the coronavirus pandemic, a situation developed in the oil market when business activity and consumption of oil products significantly decreased and world oil prices dropped due to quarantine measures.

During this period, Ukrtransnafta purchased two oil tankers at low prices. In November 2020, when oil prices increased, the company sold one tanker consignment of oil totaling 80 thousand tons of oil to BNK (UK) Limited (Great Britain), a subsidiary of CSIC Belarusian Oil Company. The sale was carried out on ITT terms from the tank farm of Pivdenny Sea Oil Terminal, with further transportation of oil by pipeline from the terminal to Mosyj Oil Refinery. In addition, Ukrtransnafta sold 30 thousand tons of remaining oil through exchange trading on the site of the Ukrainian Energy Exchange with delivery on EXW terms of the tank farm of LPDS Kremenchuk (Ukrtransnafta oil pumping station). JSC Ukruglydehydovoznya emerged as the winner of the auction.

Ukrtransnafta sold the volume of purchased oil and trade balance, having received additional profit of UAH 230 million.

**MEASURES FOR THE MODERNIZATION AND RENOVATION OF PUMPING UNITS OF THE DRUZHBA OIL PIPELINE**

In order to save energy resources, in 2020 Ukrtransnafta replaced, at the Skole linear production dispatch station of Druzhba main oil pipeline (Lviv region), physically obsolete pumping units of oil pumping units that had been in operation at the station since 1976. They were replaced by three new energy-efficient Ukrainian-made ZHON5x6-M1 oil pumps. The new pumps have improved technical characteristics. In particular, their efficiency reaches 89%, and the overhaul period is 16.5 thousand operating hours, which will reduce the cost for their maintenance and repair almost fourfold. At the same time, the service life of new equipment is at least thirty years. Thanks to the operation of modern booster pumps, the annual reduction in the volume of electricity used for oil transportation will be about 100 thousand KWh. Additionally, the replacement of equipment will increase the operational reliability of the oil pipeline, which ensures uninterrupted transit of oil to European countries on a daily basis.

**LPG TRANSPORTATION AND TRANSIT: LOGISTICS AND BUSINESS DIVERSIFICATION**

From early spring 2020, Ukrpetrotransgaz’s performed its economic activities in the conditions of significant changes in trends and market conditions. LPG market was affected by COVID-19 pandemic, social and political factors. The company provided LPG and petrochemical products transportation by rail providing service internally and for export-import operations in the amount of 310 thousands.

<table>
<thead>
<tr>
<th>Volume of transit and domestic transportation of oil</th>
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<tr>
<td><strong>2018</strong></td>
<td><strong>2019</strong></td>
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<tr>
<td>Oil transit</td>
<td>12.0</td>
</tr>
<tr>
<td>Domestic transportation</td>
<td>1.3</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>13.3</strong></td>
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**Naftogaz Group**

**Annual report 2020**
In 2020 Ukrpetrotransgaz showed zero work-related injuries. During 2020 the company donated for charity as assistance to Dolyana General Hospital in the amount of 406.0 thousand UAH to purchase oxygen supply equipment for artificial lung ventilation.

TRANSFER OF SEIZED PROPERTY OF PYKARPAZTADTRANS LLC TO UKRTRANSNAFTA FOR TEMPORARY RESPONSIBLE STORAGE

At the end of February 2021, the company, as a shareholder, agreed that Ukrtransnafta accepts the seized property of Pykarpatzakhtrans LLC, including part of the Samara-Western Direction major oil pipeline, for temporary responsible storage (without the right of use), subject to compensation for Ukrtransnafta at the expense of the state. The main purpose of this decision was to restore Ukraine’s control over the Ukrainian section of the pipeline and to ensure compliance with the Law of Ukraine “On Pipeline Transport”, in particular Article 7, according to which “The main pipeline transport has important economic and defense value and is state-owned property of Ukraine.”

In April 2021, the Asset Recovery and Management Agency, based on the results of the tender, elected Ukrtransnafta to manage part of Samara-Western Direction oil pipeline. In 2020, Pykarpatzakhtrans LLC supplied 624.2 thousand tons of diesel fuel to Ukraine via its oil pipeline (1.3 million tons in 2019), which, according to experts, is 10% and 20.3% of the total volume of diesel fuel imports to Ukraine, respectively.

In 2020, Ukrtransnafta showed zero work-related injuries.

Hydrocarbon processing and sale of fuel products, LPG and compressed natural gas (CNG)

In 2020 Naftogaz Group continued transportation of the petrochemical products manufactured by Karpatnaftokhim LLC for export and isotopotope fraction from the Republic of Belarus for the needs of ISC Ukrgasvydobuvannya.

It should be noted that in 2020 the company accepted receipt, storage and LPG transportation. This resulted in greater on the basis of the company’s assets to perform services for equipment and production modernization. Ukrspetstransgaz imports most of which were from the Russian Federation. In 2020, Ukrspetstransgaz showed zero work-related injuries. During 2020 the company donated for charity as assistance to Dolyana General Hospital in the amount of 406.0 thousand UAH to purchase oxygen supply equipment for artificial lung ventilation.
DEVELOPMENT OF TRADING BUSINESS

In 2020, a new specialized trading company, Naftogaz Oil Trading LLC, began operations. Its key activities are purchasing and selling liquid hydrocarbons and fuel products for the needs of the companies of Naftogaz Group as well as independent trading activities. At the beginning of the year, Naftogaz Oil Trading LLC concluded contracts with B&K-Ukraine for supplying 123 thousand tons of petroleum products manufactured by Belarus refineries. In 2020, the trading company bought 60 thousand tons of petroleum products (gasolines and diesel fuel) and sold the same amount on the market. The entire volume of fuel products was sold with a positive economic effect.

Compressed Natural Gas Production and Sale

Ukravtogaz performs the production and sale of CNG methane through a network of automotive gas-filling compressor stations (CNG stations). The network has 90 CNG stations (including 9 CNG stations located in temporarily uncontrolled territory). In 2019, when Ukravtogaz became part of Oil Midstream and Downstream Division, the company’s new team implemented a number of transformation measures that led to improved company performance and, as a result, the first increase in CNG sales since 2007. In 2020, announcement of the COVID-19 pandemic and introduction of quarantine led to the closure of many companies in Ukraine and around the world. This also affected the activities of Ukravtogaz. The volume of CNG sales in 2020 in the company’s network decreased by 7.1% compared to 2019.

However, the general trend in compressed natural gas sales over the last decade in Ukraine as a whole and through the Ukravtogaz network continues to fall. This trend is due to a number of factors:
— significant increase in the purchase price of natural gas since 2006 and reduction of the difference in cost of goods sold compared to diesel fuel and propane-butane;
— lack of government policy aimed at increasing the use of environmentally friendly fuels;
— aging and failure of the fleet, converted to CNG back in Soviet times;
— replacement of CNG vehicles with diesel and propane-butane vehicles by carriers;
— network of gas stations that is not sufficiently extensive;
— high market share of cheap illegal gasoline, diesel, and propane-butane sold from barrels-discounters;
— outdated and inefficient automotive gas-filling compressor stations equipment that requires significant operating and maintenance costs.

Currently, Naftogaz Group is analyzing the prospects for the development of both individual CNG stations within the perimeter of the Oil Division, and the overall prospects of the segment.

The volume of CNG sales in 2020 in

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<tr>
<td>Sales (mcm)</td>
<td>226.0</td>
<td>197.3</td>
<td>158.5</td>
<td>110.3</td>
<td>97.0</td>
<td>65.1</td>
<td>48.6</td>
<td>36.0</td>
<td>36.7</td>
<td>46.1</td>
<td>19.4</td>
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Dynamics of CNG sales through the network of Ukravtogaz

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Strategic Initiatives to Increase the Value of the Oil Division in the Segment of Hydrocarbon Refining and Sale of Oil and Condensate

The key strategic initiatives of the Oil Division in the segment of hydrocarbon refining and sale of fuel products, LPG and CNG are remain the following:
— optimization of raw material flow control system to reduce condensate and oil losses;
— implementation of measures to digitalize liquid hydrocarbon processing activities to increase operational efficiency;
— modernization of Shebelynka Gas Processing Plant.
Installation of an isomerization and hydro-treating system for the extraction of benzene-containing fraction and catalytic reforming with a capacity of 150 thousand tons per year for the production of European quality gasoline;
— construction of Khresnyshensky LPG plant with a capacity of 100 thousand tons of LPG per year in order to benefit from the extraction and sale of additional liquefied gas and condensate processing;
— construction of Solokha deep hydrocarbons extraction plant with a capacity of 70 thousand tons of LPG per year;
— construction of Mashivka deep hydrocarbons extraction plant with a capacity of 20 thousand tons of LPG per year;
— construction of a recuperation system, which will allow to reduce fuel and condensate losses at plants by using an activated carbon filter for further liquid absorption.

In addition, as part of the transition to the production and use of energy from sustainable sources, the Oil Division is actively considering entering into biofuel production segment through the implementation of a pilot project with subsequent scale-up of the business in case of successful implementation. The initiative is at the stage of preliminary feasibility study. This is in line with the agreed corporate strategy of Naftogaz Group and the goal of achieving carbon neutrality by 2040.
An important step towards improving operational efficiency was the opening in December 2020 by Ukrnafta in Prykryl of a new service center for ESP repair. As of today, it is the only facility in Ukraine, which performs incoming inspection of new ESP installations and repairs of ESP installations with the issuance of a computer-aided inspection protocol.

The base is equipped with a modern equipment (made in the USA, Germany, Great Britain), which allows to pass audit by potential foreign customers, with whom preliminary negotiations on cooperation are held, and, if necessary, to pass certification of the American Petroleum Institute (API).

The capacity of the new facilities allows to perform incoming inspection of new ESP installations and the whole cycle of ESP repair: to repair motors, hydraulic protectors, pumps, cables and other components of ESP installations. The provided services are performed in accordance with the manufacturer’s indicators after the repair the unit should completely comply with the factory settings.

**OIL AND PETROLEUM PRODUCTS SALES**

**Retail**

Ukrnafta owns the largest monobrand filling station network in Ukraine – 537 filling stations located almost in all regions of the country. As of the end of 2020, 183 of Ukrnafta’s filling stations were equipped with LPG filling points, along with 27 rebalanced filling stations (24 of which already working and 3 are expected to be completed soon) in 7 regions of Ukraine. Ukrnafta is constantly working on improving the quality of services of its filling stations network and increasing the number of additional service that Ukrnafta’s stations can provide. In 2020, the company launched 8 rebalanced filling stations in Rivne, Temioxide, Zhytomir, Ivano-Frankivsk, and Zakarpattia regions.

**Commodity exchange operations**

Throughout 2017-2020, the company was unable to sell oil and gas condensate at nearly 50% of auctions because of absence of willing buyers. In 2019, out of 20 oil and condensate auctions, 11 auctions were declared as failed. During the reporting year, Ukrnafta continued to operate under regulatory restrictions on the sale of oil and gas condensate related to the requirement to sell them through a system of state auctions.

In 2020, according to the schedule of exchange auctions for the sale of crude oil and gas condensate of PSC Ukrnafta production, 21 auctions were organized. During the period from January 1, 2020 to December 31, 2020, the sale of raw materials took place at only 8 auctions: due to below market prices and the lack of interested buyers, the Company was forced to purchase its own oil for further transfer to the Kremenchug refinery on toll terms and incur additional costs related to the monetization of oil.

In 2020, through state exchange auctions the company sold 1,605.6 thousand tons of oil and condensate including 2020 production volume and 2019 stock volume. All trades took place at only 8 auctions. Due to below market prices and the lack of interested buyers, the Company was forced to purchase its own oil for further transfer to the Kremenchug refinery on toll terms and incur additional costs related to the monetization of oil.

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In 2020, Ukrnafta transferred UAH 28.9 billion to the special fund of the State Budget. This amount includes debt on VAT, profit tax, and rental payment, accrued fines and penalties for late payment of monetary liabilities. Ukrnafta also paid UAH 3.9 billion of current liabilities for VAT and UAH 3.3 billion of advance payments of income tax to the special fund of the state budget as a result of implementation of agreements on gas sales. Implementation of gas agreements between the companies became possible after the adoption by the Verkhovna Rada of Ukraine of laws 1005-IX and 1006-IX and the resolution of the Cabinet of Ministers of Ukraine No. 1195.

Settlement of the tax debt issue came as a result of coordinated actions of the Supervisory Boards and the Management Boards of Ukrnafta, Naftogaz, and support of the Government. Ukrnafta intends to focus on strategic tasks and the formation of conditions that will ensure a sustainable increase in oil and gas production in the interests of Ukraine’s energy security.

CORPORATE GOVERNANCE REFORM

Following the corporate governance reform starting in 2019 which set up the new Charter of Ukrnafta according to Ukrainian law and OECD recommendations, at the end of 2020, the company developed, and the Supervisory Board approved, the Code of Corporate Ethics of Ukrnafta. This document brings together important values and principles of doing business for Ukrnafta. It sets out rules of conduct and interaction for employees, standards of relations with partners, anti-corruption policies, conflicts of interest, and many other fundamental aspects.

In 2020, in accordance with the decisions of the Supervisory Board of the company, Oleg Gez was appointed Chairman of the Executive Board. Dmytro Mordovenko has been appointed Deputy Chairman of the Management Board, Executive Vice President for Corporate Strategy and Development.

UKRNAFTA’S KEY FINANCIAL INDICATORS

2020 saw Ukrnafta spend the least in terms of basic material expenditure and capital investments, yet the company’s production volumes remained nearly flat (0.9% less oil and 3% less gas than in 2019). This is an enormous achievement considering the difficult environment in which the company has operated.

In 2020, Ukrnafta received a net profit of UAH 4.269 bn compared to UAH 4.058 bn net loss in 2019. The company’s assets decreased by 1% at the end of 2020 and amounted to UAH 38.07 bn compared to UAH 42.92 billion at the end of 2019. In 2020, total receivables decreased to UAH 6.44 bn compared to UAH 7.44 bn previous year.

ASSETS SPLIT BETWEEN NAFTOGAZ AND THE MINORITY SHAREHOLDER

Late in 2020, following tax-debt settlement, Naftogaz initiated a discussion on the settlement of interests of all shareholders. Naftogaz considers the split of Ukrnafta assets with the minority shareholder as a possible solution. The transfer of part of Ukrnafta’s assets for Naftogaz to gain full control over its stake will allow the company to become much more transparent in future, especially in light of its IPO ambitions, as envisaged in Naftogaz’s Ownership Policy approved in October 2020.

2021 KEY DIRECTIONS AND CHALLENGES

The company’s strategic tasks for 2021 are set as follows:

1. Investments in development, fast-paying mining projects, critical infrastructure.
2. Ensuring current operational needs.
3. Increasing sales of own hydrocarbons.
4. Increasing sales of petroleum products.
5. Timely fulfillment of critical obligations.

Challenges and solutions:

Regulatory limitations on oil sales. An important condition for accelerating the development of Ukrnafta is the removal of regulatory restrictions and the uninterrupted sale of oil and condensate on a regular basis and market conditions. Ukrnafta has repeatedly stressed and continues to emphasize to the Government the importance of solving this problem.

The company considers the two main conditions which should be met in order to solve the problem of regulatory restrictions:

— Ensure the purchase of the entire volume of oil.
— Guarantee the market price for seller and buyer.

Unbalanced policy on fuel excise tax rates. Due to four times lower rates of excise tax on LPG compared to gasoline, there is a rapid increase in LPG consumption and a reduction in gasoline consumption by 5-10% annually. The current excise policy has already led to increased dependency on imported fuel products, which come mainly from Russia.

Incentive rates for new oil wells. In 2020, Ukraine continued to increase incentive rates for new gas wells: 12% for reserves up to 5,000 meters and 6% for deeper reserves, which had a positive effect on the development of gas production in the country. The company proposed to the relevant public authorities to extend a similar tax regime to oil production from new wells. Ukrnafta believes that these measures will increase the volume of drilling and production of liquid hydrocarbons and will lead to increased revenues to the state budget from rent payments. Despite the fact that the company’s proposals have remained without feedback, Ukrnafta will continue to emphasize the importance of stimulating domestic oil and condensate production.
Address of Naftogaz Group Transformation Office Director

Last year was difficult for all of us. Despite the pandemic and remote work, Naftogaz Group's transformation processes gained momentum, with ambitious plans and goals ahead.

Our goal is to make Naftogaz a corporate reform leader among Ukrainian state-owned companies. We aim to make Naftogaz modern, efficient business and to strengthen its role in ensuring the country’s energy independence. And we are strongly committed to these goals.

ORGANIZATIONAL TRANSFORMATION
In 2020, the Transformation Office worked hard to create and implement a new operational matrix model with clear rules of interaction, strong leaders, and personal responsibility. The Office has implemented systematic and critical changes aimed at the transition to a qualitatively new state:
— Organizational transformation;
— Implementation of a process-based approach and improved operational efficiency;
— Leadership and culture.

During 2020, the largest division – “Integrated Gas Business” – was restructured, and two new divisions – “Commerce” and “Retail” – were created as part of this transformation. A total of 8 divisions, forming a specific business or functional operational area, have been established. Each division is independent in improving its efficiency, and the head of the division is fully responsible for performance.

The operation of these divisions is supported by corporate functions, aimed primarily at reducing bureaucracy, as well as the practice of multi-channel reporting and duplication of processes and functions. Corporate functions are designed to support the activities of divisions by improving the quality of service and achieving operational excellence. To date, 15 corporate functions have been launched. To clearly define the key roles and responsibilities in the new operational matrix model, the Transformation Office has developed the core document “Naftogaz Group Division and Corporate Function Management Procedure”, which determines interaction between the Group’s divisions and corporate functions.

BUSINESS PROCESSES AND OPERATIONAL EFFICIENCY
After having defined the basic operational principles for Naftogaz Group’s divisions and functions, the Transformation Office has developed a number of policies and regulations to streamline internal processes and key business processes. Additionally, Naftogaz Group’s Project Management Policy was developed in 2020. The Policy promotes project management within the Company.

In 2020, a Single Register of Business Processes (Levels 1 and 2) of Naftogaz Group was created and approved. The Register is designed to monitor business processes in the Group in a systemic way clearly define responsibilities of each division and function.

Changes in the risk management process are another important achievement of the past year. The centralized corporate function “Naftogaz Group Risk Management” was established and the Risk Management Policy and Regulations were approved, which are the basis for the development of new approaches towards improving risk management efficiency. For the first time, the TOP-20 risks were identified and approved by the Supervisory Board. The systematic and effective approach of the Group’s management has reduced the impact of some long-term systematic problems.

RIGHTSIZING PROJECT
The Group’s new operational matrix model requires a functional structure that would enable the divisions and corporate functions to achieve their strategic goals. The updated functional structure should eliminate duplication of functions, outdated rules and procedures that create internal bureaucracy, paperwork, a closed-door management culture, and the remoteness of the Group’s legal entities.

The Rightsizing project is aimed at the development and implementation of the new functional structure of the Naftogaz Group. The Transformation Office has developed the principles of building up the right organizational structure (Rightsizing) and a detailed project plan. As a result, all functional and administrative structures are consolidated by division, corporate function, and legal entity of the Naftogaz Group in accordance with updated standards for a flat and efficient structure.

PROCUREMENT
The Naftogaz Group Procurement Transformation Project is one of the key transformation projects implemented in 2020. Procurement is an extremely important process which is scrutinized by the general public. As a part of the project, main and local contracting councils have been established within the corporate function of Naftogaz Group Financial Management. These councils are focused on development and implementation of a procurement contract management model to ensure effective supply chain management within the Group.

Procurement management has been separated from Technical Support Division into a separate corporate function, Procurement Management, which continues the procurement transformation process in 2021. According to our estimates, the reform of the procurement function would result in savings of USD 100-150 million.

LEADERSHIP AND CULTURE
Naftogaz Group corporate culture development is a special area of transformation, with the most challenging internal transformation being that of each individual employee of the Group. We understand that changing people’s mindset is a difficult and time-consuming process, but it is necessary. Changing the Group’s culture to a culture of interaction, support, and trust is one of the key challenges.

In 2020, the Transformation Office initiated a number of activities designed to change perceptions of Naftogaz Group as a single corporation, change the corporate culture of the Group, and increase efficiency starting with the efficiency of company managers.

Our priority is the development of the TOP-20 leaders of the Group. We hope that the leaders of Naftogaz Group will become the drivers of a new corporate culture, which would enable employees to openly express their opinion, initiate and support changes.

Also in 2020, the Transformation Office launched regular intra-group quality surveys: the first basic survey of the Group’s internal customers to gauge their satisfaction with key functions was conducted. The Transformation Office used the results from interviews with the Group’s employees as input to evaluate changes in the company and identify gaps.

We make every effort to ensure that all changes in the Group are dynamic and irreversible. To communicate key changes and transformations in the Group, we have created a dedicated Naftogaz Transformation page on the corporate portal, where news and results are published.

Continuous improvement is an integral part of the Group’s policy. Like all leading energy companies, we will have to make difficult decisions. We have no alternative. Increased efficiency and competitiveness is the only way to achieve our goal – to become a public joint stock company.

“Like all leading energy companies, we will have to make difficult decisions and change. There is no alternative”

Olena Korotchuk
Naftogaz Group Transformation Office Director
Transformation

Transformation is an essential condition for our goals achievement

**Naftogaz Group transformation successes in 2020**

**ORGANIZATIONAL TRANSFORMATION**
- Changed >50% of senior leadership
- Decrease of bureaucracy according to delegation of authority and new policy for Management of Naftogaz Group Business divisions and corporate functions
- Reorganized risk management system
- Implemented Naftogaz Group-wide matrix operating model with clear standards, principles, roles and responsibilities
- Restructured and created new divisions and corporate functions
- Implemented cooperation standards for divisions and corporate functions
- Implemented an effective goal setting system (OKR) for the top-20, followed by cascading to lower levels

**BUSINESS-PROCESSES REENGINEERING**
- Developed and implemented unified standards and taxonomy of internal documents for Naftogaz Group
- Implemented business-processes standardization methodology
- Updated policies and procedures
- Created and approved the Register of business-processes (1 and 2 levels)
- Created project management function, that implements unified standards of project management in the Group
- Strengthened control of cashflow and capital expenditures, as a result:
  - Capex - 25% reduction, Opex - 5% reduction
- Implemented new approach to contract management according to international standards incl. Contract Boards functioning
- Optimized warehouse logistics
- Implemented category management in the procurement process
- Integrated budgeting and planning cycles
- Updated group-wide investment policies and procedures

**LEADERSHIP AND CULTURE**
- Created and attracted to changes the top-100 leaders’ community of Naftogaz Group
- Strengthened the perception of Naftogaz Group as a united team
- Focused on HSE and no accidents (fatalities in production & operation activities)
- Increased efficiency of cross-functional cooperation in Naftogaz Group
- Developed and implemented Transformation communication plan
- Developed transformational branding: logo, posters, brandbook, web-page, weekly newsletters, screen savers, Q&A
- Developed and implemented training program for top-100 leaders of Naftogaz Group
- Updated of OKR establishment model according to the transformation goals and culture development
- Implemented 360-degree feedback method for top-management

**Stages of Naftogaz Transformation**

**2020**
- Preparation & Turnaround
  - Developed transformation plan 2020
  - Started transformation processes of Naftogaz Group
  - Implemented matrix operating model
  - Created corporate functions and divisions
  - Implemented process approach
  - Created basis for development of corporate culture
  - Strengthened cooperation between top-100 and top-20 leaders of Naftogaz Group
  - Developed the approach of right sizing implementation that focused on divisions and corporate functions

**2021**
- Strategic initiatives implementation
  - Operational efficiency & Cost focus
  - Naftogaz Group centralization, simplification and optimization
  - SCM implementation
  - Providing the approach of rightsizing implementation that focused on operational efficiency of Naftogaz Group
  - Leadership development
  - HR processes reengineering
  - Implementation of a comprehensive change management system

**2022 and next**
- Naftogaz Group potential realization
  - Agile & effective operating model
  - Modern SCM
  - Digitalization
  - Industry 4.0
  - Production targets fulfilled
  - Strategic projects/products focus
  - Cost control
  - Fulfilled people and organizational potential

**2021 priorities: value-adding drivers**

**GOVERNANCE**
- More focus on Value adding
  - Delegation of Authority
  - Performance management implementation (business-processes KPIs, OKR 2021 approach, 360-degree assessment)
  - Organizational standards development & implementation
  - Corporate values unification & consolidation
  - Executive Board approval process optimization

**OPERATING MODEL**
- Effective services & interfaces
  - BPs & CFs critical interfaces (Business partners models & SLA standards, Client satisfaction survey)
  - BPs register updated & owners
  - New BPs & CFs establishment, structure updating
  - Management Policy updating
  - Simplification: optimize & consolidate branches & LEs
  - Improving the efficiency of supply chain management

**OPERATIONAL EFFICIENCY**
- Critical KPIs & deliverables
  - E&P Oper. excellence program development & implementation
  - Rightsizing 2020: finalization & delivery
  - Rightsizing 2021: framing & implementation
  - Production core BPs management
  - BP HR reengineering

**CHANGE MANAGEMENT**
- How we work
  - Expand Change management to support all critical BPs
  - Communication plan development & implementation
  - Project management system implementation
  - Group Corporate portal: project launching
  - HR environmental & OMI improvement
  - Group-wide Methodology & Standards database launching
  - Group-wide Implementation of behavioral standards and rules of cross-functional cooperation

**COMPETENCIES DEVELOPMENT**
- Our professional future
  - Leadership program top-50
  - Critical Competencies identification & development
  - Lean and project management program development & implementation
Human resources management

Creating favorable conditions for effective employee performance is one of Naftogaz Group’s key priorities. Naftogaz Group, as a socially responsible company, guarantees its employees fair wages, opportunities for learning and developing their professional, technical, and managerial competencies; provides them and their families with social support; and prevents cases of discrimination or human rights breaches at work. The company’s corporate culture encourages initiative, responsibility, loyalty, discipline and proper work, high ethical standards, expertise, and cooperation. High corporate conduct standards are ensured by the Code of Corporate Ethics: All employees regardless of their responsibility must follow the provisions and rules of conduct set in the Code.

Naftogaz Group was awarded as the National Employer of Choice according to a global survey held by Randstad Employer Brand Research (Ukraine) among more than 185,000 respondents in 33 countries who evaluated over 6,000 companies.

Almost 8,000 Ukrainians participated in the survey. They evaluated 150 of the biggest employers, including 75 Ukrainian and 75 international companies operating in 13 industries. The winners were decided based on the following criteria: financial reliability; innovations and technology; reputation; career growth; security of job; satisfying job; decent salary; perks. The company's corporate culture encourages initiative, responsibility, loyalty, discipline and proper work, high ethical standards, expertise, and cooperation. High corporate conduct standards are ensured by the Code of Corporate Ethics: All employees regardless of their responsibility must follow the provisions and rules of conduct set in the Code.

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The urgent need to organize remote work for many employees because of the coronavirus pandemic was both a big challenge and new experience for us. The HR function of Naftogaz Group successfully coped with this challenge and organized flawless documentation of massive transition to remote work, ensuring the uninterrupted day-to-day operation of Group enterprises and protecting employee health. The HR function also facilitated financial and organizational support for employees who were severely hit by COVID-19, helping them to overcome the virus both physically and psychologically.

Human Resources Policy of Naftogaz Group was introduced in 2020. The Policy identifies key areas in HR management and provides a framework for unleashing the professional potential of employees. The document guarantees a level playing field for all employees; prohibits any form of discrimination or harassment at work, the use of forced or child labor. The Policy guarantees Naftogaz Group employees freedom of association, including trade unions, conclusion of trade union contracts, and collective bargaining.

Employees should inform their managers about any violations of the Policy or use the Naftogaz Group trust line. The company checks and investigates all reported violations of rules of conduct and properly responds to them, maintaining confidentiality. The Policy prohibits threats, hostile acts, or harassment towards employees who submitted complaints while policy-breakers are subject to disciplinary action under current law.

Digitalized HR Management System

With transformation underway, the introduction of a Talent Management System (TMS) was a key achievement of Naftogaz Group’s HR function in 2020, offering employees various opportunities for career growth.

TMS is a software solution for HR management and automation of the following processes: recruitment and internal contexts for vacancies; learning, managing individual objectives and key results; assessment of employees and planning career growth. The TMS was supplied by Cornerstone OnDemand, a global leader in human potential development. After the conclusion of the contract, the HR team of Naftogaz Group, with the support of Naftogaz Digital Technologies, customized the system to the company’s needs and facilitated its launch.

The system will become a digital platform for communication related to HR management and help save time needed to agree and sign documents. TMS can be used in office or remotely, which will improve employee productivity. The system provides staff members with access to available vacancies within Naftogaz Group, free on-line learning at any convenient time, individual development planning for building new competencies, feedback from a supervisor, and transparent opportunities for planning careers in the company.

The TMS currently includes three fully functional modules. The learning module so far covers about 11,000 users. The last, career management, module is to be introduced in the first half of 2021. This will complete the automation of the entire cycle of HR management functions in the organization.

Staff Composition

As of the end of 2020, the total number of Naftogaz Group full-time employees was 51,947, which is 5.7% less against 2019 (55,078). Most Naftogaz Group employees are men – 76.0% (39,485). Women make up 24.0% (11,462). This substantial difference is due to the specific nature of the industry. More than 90% of Naftogaz Group employees are accounted for by the Group’s four biggest companies – Ukrtrans (40% or 20,763 persons), Ukrtransvydobuvannya (34.1% or 17,727 persons), Ukrtransag (11.0% or 5,740 persons), and Ukrtransnafta (5.4% or 2,820 persons). The share of managers in the total number of Naftogaz Group full-time employees in 2020 amounted to 11.9% (6,199 persons), professionals and specialists accounted for 19.9% (10,310 persons), technical staff – 0.4% (225 persons), qualified and other workers – 67.8% (35,213 persons).

The age structure was the following: employees aged 30–50 – 31,809 persons (61.3%), under 30 – 4,008 persons (9.4%), and over 50 – 15,230 persons (29.3%). Employees of retirement age amount to 2,028 persons (3.9%).

The share of Naftogaz Group employees involved in production of crude oil and natural gas was 27.2% (33,799 persons), land and pipeline transportation – 12.0% (6,087 persons), and other operations of the Group’s production enterprises 60.8% (30,777 persons).

Staff turnover rate was 2.5% in 2020 compared to 3.9% in 2019. 10,451 employees were dismissed in the reporting year: 1,275 employees resigned, 23 were fired for labor misconduct, and the rest left for other reasons, including family circumstances, relocation, retirement, etc.

Downsizing in 2020 was due to transformation processes within the company: following TSO unbundling, a number of Ukrtransag employees were dismissed according to current law and trade union contract; the closure of Kremenchuk, Kherson, and Lviv support bases along with the transition to a two-tier management structure in Ukrtransag led to a decrease in the number of employees compared to 2019; the rightsizing of Ukrtransagvydobuvannya staff involved in auxiliary, supporting, and non-core functions that are not part of the company’s core business activities, including the downsizing of Ukrtransag drilling unit due to a substantial decrease in annual drilling targets; the reorganization of Ukmsta and improvement of the company’s structure and business processes led to an insignificant decrease in staff.

Staff Remuneration

Naftogaz Group continues to improve employment conditions and boost its reputation as a responsible employer. The company introduced a grading remuneration system linking employee remuneration to their specific results. The grading system helped improve quantifiable and qualitative performance indicators and enhance motivation tools, enabling better consideration of individual characteristics of each staff member and their work. Upon the recommendations of the supervisory board, Naftogaz Group also reformed the bonus system: the quarterly bonus system was canceled but compensated for with increased fixed monthly income and annual bonus, so the total income of employees remained intact.

The average monthly wage within Naftogaz Group increased by 7.9% in 2020 against the previous year. According to the State Statistics Service, this indicator grew by 10% across Ukraine and by 8% in the industrial sector.

Increasing wages is one of the most effective tools the company uses to retain employees in response to such threats and risks as deficit of work-force, outgoing labor migration of qualified workers, higher inflation and cost of living, etc.

Social Security

To improve quality of life, motivation and involvement of employees, Naftogaz Group implements a social policy aimed at maintaining employee physical and mental health. In 2020, Naftogaz Group companies spent UAH 2,088.2 million on social activities, which is 15% less compared to the previous year (please see below spending details broken down by expenditure item and company).

Lower expenses on financial assistance, accommodation, social benefits and guarantees, and other payments were mostly due to the TSO unbundling process, with a number of Ukrtransag employees having been transferred to the GTS Operator, and the downsizing in Ukrtransag.

Expenses on maintaining social infrastructure facilities decreased after almost a third of Ukrtransagvydobuvannya’s boiler rooms were closed and some cafeterias had been handed over to contractors. The handover of some recreation facilities from
**STAFF TRAINING AND DEVELOPMENT**

Naftogaz Group’s training and professional development activities seek to encourage career and professional growth, build competencies, obtain new knowledge and skills, and ensure that employees have basic HSE knowledge and skills. When implementing training programs, the company cooperates with leading national and international educational institutions and encourages knowledge-sharing among its employees. 99.3% (16,393 employees) of Naftogaz Group managers, professionals, and experts have complete, incomplete, or basic higher education. Some Naftogaz Group employees have postgraduate degrees: 175 PhDs, including 39 women; and 9 Doctors, including 2 women. 18 employees have academic titles, including 8 associate professors, 9 senior researchers, and 1 professor.

In the reporting period, more than 25,580 Naftogaz Group employees passed training and professional improvement programs: 58.7% – Ukrtransnafta, 36.6% – Ukrgasvydobuvannya, 3.0% – Uktransgaz, 1.3% – Uktransnafta, and other (Ukrtransgaz, Naftogaz of Ukraine Gas Supply Company) – 0.3%. The employees of the mentioned companies had almost 167,600 hours of training in 2020. The average number of training hours per employee was 7.78 for Ukrtransgaz, 2.35 for Uktransgaz, 2.28 for Ukrtransnafta, 0.79 for Uktransgaz, and 15.00 for Naftogaz of Ukraine Gas Supply Company.

**UKRASVYDOBUVANNA**

In 2020, in order to improve professional skills of its employees, Ukrasvydobuvannya continued active cooperation under concluded agreements with international leaders Nabors Drilling International Limited, Schlumberger, Solar Turbines, and Deloitte. Training sessions covered operation and maintenance of drilling equipment and professional improvement of engineers and technicians involved in drilling support. Considering the COVID-19 pandemic, online training was a top priority for the company.

Ukrasvydobuvannya’s key achievement in the reporting period was the Drilling School project, which won the HR Brand Ukraine 2020 award as the best employee training and development project. The project is a unique center for developing drilling competencies, which was implemented in cooperation with NEXT (Schlumberger). The company is the leader among international training companies in the industry. It has a solid technical basis with more than 700 courses covering all areas of oil and gas exploration and production.

Ukrasvydobuvannya also held the following training and professional development activities:
- Further implementation of in-house mentoring program: 28 employees of the company were selected to participate in the program, and 9 successfully completed training for the program. The program was extended for 2021 and is to be scaled to other Naftogaz Group companies.
- 5,045 Ukrasvydobuvannya employees improved their professional skills or were retrained in the training center of Shchelykivskasvodobuvannya.
- HSE training sessions were held. A program of the National Examination Board in Occupational Safety and Health was introduced for Ukrasvydobuvannya HSE professionals. The program embraces health and safety and risk management issues, providing learning, testing, and evaluation tools.
- Began leadership competencies training for junior and middle managers, including effective communication, motivation, and basis of management.

**NAFTOGAZ OF UKRAINE**

In 2020, Naftogaz of Ukraine NISIC introduced a Professional Improvement and Development Plan. 240 employees participated in various training activities in the reporting period. 364 man hours were held, including Finance for Non-Financial Managers and Business Analysis corporate training events.
**MBA PROGRAM AT THE KYIV SCHOOL OF ECONOMICS**

Naftogaz Group trade unions initiated the extension of an MBA SOE Management Program at the Kyiv School of Economics, a long-term training project for high-potential employees. The program featured participation by employees of Naftogaz of Ukraine, Ukrtransnafta, Naftogaz Teplo, and Naftogaz of Ukraine Gas Supply Company.

The project was initiated to facilitate the competitiveness of state-owned enterprises through the implementation of up-to-date management standards and changes in corporate culture. Five groups of Naftogaz employees completed the program and defended their graduation theses. 115 employees have participated in the program so far.

**UKRAINIAN MODERN ENGINEERING STUDIOS**

The Ukrainian Modern Engineering Studios (UMES) education program continued in 2020. The project aims at transforming engineering education in order to provide oil and gas industry enterprises with up-to-date highly qualified technical specialists. The UMES was initiated by Naftogaz of Ukraine jointly with the Southern Alberta Institute of Technology, Canada, and the Federation of Oil and Gas Industry Employers, the Kyiv City Organization of Oil and Gas Industry Employers, and implemented at Yuri Kondratyuk National University Polytechnica and Kharkiv Beketov National University of Urban Economics.

This is the most up-to-date and innovative training program for engineering professionals. Successful implementation of the project will contribute to the sustainable development of the country’s oil and gas sector and other sectors of the economy in a long-term perspective.

**INvolVING YOUNG PROFESSIONALS**

Ukrgasvydobuvannya continues to cooperate with specialized educational institutions in Ukraine, providing students with internship and employment opportunities at the company’s branches. Cooperation with educational institutions in this area is based on long-term cooperation agreements for training oil and gas professionals. In 2020, Ukrgasvydobuvannya provided internship at its branches for 621 students from Ukrainian specialized educational institutions. 29 students passed their practical training with Ukrtransnafta, and 22 students did so with Ukrtransgaz.

**PLANS FOR 2021**

— Implement the Better Education for Effective and Environmentally Friendly Gas Production project. In 2021, within the framework of the project, 20 professors of Kharkiv Beketov National University of Urban Economics will pass an internship program in Naftogaz Group companies to obtain up-to-date practical skills needed in the oil and gas industry.

— Complete the implementation of the Talent Management System across Naftogaz Group.

**COOPERATION WITH EDUCATIONAL INSTITUTIONS**

In 2020, Naftogaz Group continued active cooperation with educational institutions. Ukrgasvydobuvannya also held the following training and professional development activities:

— Further implementation of in-house mentoring program: 22 employees of the company were selected to participate in the program, and 9 successfully completed training for trainers. The program was extended for 2021 and is to be scaled to other Naftogaz Group companies.

— 5,046 Ukrgasvydobuvannya employees improved their professional skills or were retrained in the training center of Shebelynkapogazvydobuvannya.

**HOURS OF TRAINING IN THE REPORTING PERIOD BY COMPANY IN 2020**

<table>
<thead>
<tr>
<th>Hours of training</th>
<th>Total</th>
<th>Ukrafta</th>
<th>Ukrgazvydobuvannya</th>
<th>Ukrtransnafta</th>
<th>Ukrtransgaz</th>
<th>Ukrtransnafta</th>
<th>Ukrtransgaz</th>
<th>Naftogaz of Ukraine Gas Supply Company</th>
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</thead>
<tbody>
<tr>
<td>Ukrafta</td>
<td>2,75</td>
<td>2,71</td>
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<tr>
<td>Ukrtransgaz</td>
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<td>1.00</td>
<td>1.00</td>
<td></td>
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</tbody>
</table>

**TOTAL HOURS OF TRAINING**

517,596 hours – total hours of training.
According to Article 19 of the Law of Ukraine «On Occupational Health and Safety», activities aimed at reducing the risks of occupational injuries and improving working conditions are identified to prevent occupational injuries and to improve working conditions. In 2020, the company introduced this certification, the company develops and takes measures to improve the existing level of OHS standards and improve the existing level of OHS services by third party organizations at the facilities of Naftogaz Group enterprises. In addition, the Board approved the following documents setting the OHS goals and action plans in Naftogaz Group for 2021:

- Goals and objectives of Naftogaz of Ukraine NJSC in occupational safety and health, road safety and measures to achieve them in 2021.
- Action plan to increase the level of occupational safety and health of Naftogaz Group employees for 2021 (in view of the order of the Ministry of Energy of Ukraine dated 02.12.2020 No 774 “On Approval of the Action to improve the existing occupational safety and health at enterprises under the Ministry of Energy for 2021”).
- Schedule of inspections of Naftogaz Group enterprises on occupational safety and health and road safety in 2021.

In addition, the Group’s companies are regularly inspected for their compliance with fire safety regulations. In 2020, the company’s authorized units carried out 4,599 inspections of the Naftogaz Group’s facilities, which identified 17,557 violations. Following these inspections, 16,530 violations were eliminated. 29 disciplinary sanctions were imposed for violating fire safety rules. During the year, the State Emergency Service of Ukraine (SES) conducted 18 inspections, which revealed 109 violations, of which 56 were eliminated.

The measures taken by the company for fire safety were:

- Of 2020, Naftogaz Group employed 169 fire safety specialists, including 88 full-time employees. In addition, 360 fire technical commissions and 263 fire brigades are established at the company’s enterprises. These include 969 and 1,824 people, respectively.
- The company has 50 fire motor pumps, 482 automatic fire extinguishing systems, 926 mobile fire extinguishing systems, 2,034 automatic fire alarm systems, 887 fire poles, 820 tons of foaming agent, and more.
- 148 fire trucks owned by the Company stand ready for firefighting, including 81 trucks in stand-by mode round-the-clock.
- The facilities of the enterprises are guarded by 24 fire and rescue units of the State Emergency Service of Ukraine with 84 fire trucks. The number of personnel in these units is 864 people.
- During the reporting period, the Company independently conducted 2,861 on-site fire training sessions, and 251 training sessions together with SES units.
- The largest share of expenses in 2020 was the fee of the SES fire brigades engaged in fire protection of the company’s facilities on a contractual basis.

PREVENTING THE SPREAD OF COVID-19

In 2020, Naftogaz Group worked actively in pandemic conditions to prevent the company’s employees from being infected with COVID-19. Key decisions and activities of Naftogaz Group included the following:

- establishment of a command center for COVID-19 pandemic rapid response, counteraction, prevention of infection and its consequences;
- approval of regulations in case of acute respiratory viral infections and coronavirus infection for Naftogaz Group employees;
- approval of a memo on self-isolation in case of infection for company employees;
- development of a technical passport and preparation of a memo on the use of clothing and footwear aerodispersion systems for employees; Measures to prevent the spread of coronavirus were carried out at enterprises, branches, and structural subdivisions of Naftogaz Group, including:
  - mandatory protective masks;
  - availability of sanitizers; and
  - daily systematic body temperature measurement;

OHS MANAGEMENT Naftogaz Group’s "Vision of Occupational Health and Safety, Industrial Safety and Environmental Protection" (Vision Zero), approved in 2019, stipulates its key values and strategic goals in occupational health and safety. This Vision is aimed at the achievement of zero mortality, zero time lost due to accidents, zero injuries, and zero damage to the environment.

Naftogaz Group, in its practical approaches to creating safe and healthy working conditions along with the prevention of accidents and occupational diseases at enterprises, is guided by the provisions of the Law of Ukraine “On Occupational Health and Safety” regulatory OHS documents and the sectoral standard SOU 70.1-20077720-073:2017 “Occupational Health and Safety Management at the National Joint Stock Company Naftogaz of Ukraine. Substantive provisions.” In accordance with the requirements of this standard, the effectiveness and results of preventive OHS work are assessed on a quarterly basis. Work accidents are analyzed at the enterprise level and by Naftogaz Group as a whole. In addition, during 2020, comprehensive activities to achieve the agreed safety standards and improve the existing level of OHS services were implemented.

The occupational health and safety management system at Naftogaz Group enterprises includes five levels of monitoring the state of OHS, with on-site inspections of production units and workplaces. In 2020, 1,547 jobs were certified at Naftogaz Group enterprises for working conditions. Based on the results of this certification, the company develops and takes measures to improve working conditions. In 2020, the company introduced a Uniform system for monitoring the OHS, environmental, and industrial safety processes.

In addition, the state of OHS is discussed at working meetings of the Group’s enterprises and general meetings of labor collectives. Based on the results of these discussions, additional measures are identified to prevent occupational injuries and occupational diseases.

During 2020, the Board of Naftogaz of Ukraine NJSC prepared and approved a number of documents and projects specifying the activities aimed at reducing the risks of occupational injuries and improving working conditions:


In 2020, Naftogaz Ukraine was certified by the certification agency TUV SUD Management Service GmbH for compliance with the international standard ISO 45001:2018 «Occupational Health and Safety Management Systems».
Special wet cleaning and disinfection. Rapid inspections of compliance with the requirements of the anti-epidemic regime were regularly conducted, and based on their results, measures were taken to eliminate deficiencies and improve efforts to prevent the spread of the disease.

**OCCUPATIONAL HEALTH AND SAFETY TRAINING**

Naftogaz Group provides regular OSH training to employees. In 2020, a number of online courses were delivered, namely:

- “Risk management in occupational health and safety management systems, civil protection and emergencies, fire safety, road safety” (7 relevant profile specialists were trained);
- “COVID-19: New challenges to building a Company continuity management system” (19 relevant profile specialists were trained).

In 2020, 20 employees were trained in how to provide first aid to accident victims. Other online events included webinars on compliance with safe working conditions requirements. The State Labor Service of Ukraine and the European Agency for Safety & Health at Work participated in these webinars and contributed to their organization.

**OCCUPATIONAL INJURIES**

In 2020, 19 accidents occurred at Naftogaz Group enterprises, including 2 group accidents, which is 20.8% less than in the reporting period. In 2019, 24 employees were injured. In 2020, 17 employees were injured.

The number of offenses against Naftogaz Group property, a new security system was introduced in 2020, in addition to car patrols. This new approach implies creating a plan of the pipeline protected zone, which would enable monitoring of illegal interference in the infrastructure of enterprises, in addition, unmanned aerial vehicles are used to air patrol pipelines areas, which allow to record both already implemented insertions and preparation works. Possible interventions in the transport system are also monitored through in-tube diagnostics, which allows to track pressure drops and other changes in the technical characteristics of the system. During 2020, new approaches for the protection of the company’s facilities helped prevent 13 illegal interventions and detect 37 pipeline intrusions, which prevented losses of about USD 17 million.

**SAFETY IN OCCUPATIONAL HEALTH AND SAFETY TRAINING**

To maintain the accident-free technical condition of major oil transmission system, Ukrtransnafta implemented the following activities in 2020:

- in-pipe diagnostics of 70 km of major oil pipelines;
- elimination of 522 defects of the linear part of the major oil pipelines and 25 malicious damages on the linear part of the oil pipelines;
- comprehensive instrument-aided survey of 1,030 km of the linear part of major oil pipelines;
- overhaul of 18 sets of anode groundings of cathodic protection stations, 4 drainage installations;
- scheduled maintenance of 11 pumps and 74 electric motors on oil pumping units;
- decommissioning of 28 tanks for their further repair or for expert examination;
- overhaul of 4 tanks.

**SAFETY OF OIL AND GAS FACILITIES**

The number of offenses against Naftogaz Group property remains significant, despite the activities of law enforcement agencies and the relevant divisions of the Group’s companies to prevent, detect, and stop such illegal actions. In 2020, 121 offenses against Naftogaz Group property were recorded, namely:

- 59 traffics of hydrocarbons – illicit removals of oil, gas, and condensate from major and industrial pipelines by destroying the protective layer of insulation and drilling of the pipe.

In addition, 6 premature (sudden) deaths not related to the production process were recorded at Naftogaz Group enterprises during the reporting period: 4 at Ukrtransgaz JSC enterprises, 1 at Ukrtransnafta JSC and 1 at Ukrtransgaz JSC. In most cases, the death was caused by cardiovascular disease (14 such cases in 2019). No cases of occupational disease were reported in 2020. Accidents during production processes, occupational injuries, and diseases are recorded in accordance with the Procedure for Investigation and Recording of Accidents, Occupational Diseases and Accidents at Work, approved by the Cabinet of Ministers of Ukraine on 17.04.2019 No 537. Occupational injuries are reviewed and analyzed in accordance with the Procedure, and the relevant safeguards are taken. In cases of high consequence accidents and traffic accidents, official investigations are conducted, and officials and other employees responsible for the situations are held to account.

**PLANS FOR 2021**

- implementation of measures to prevent workers from contracting coronavirus infection (COVID-19);
- launch of construction work on some energy and safety, civil protection, environmental, radiation, fire, man-caused, industrial safety, road safety and technical supervision Management Function in Naftogaz Group, approved by the Company’s Management Board;
- development of regulations on conducting occupational safety and health and road safety behavioral audits and approval by the Board.

![Number of accidents in 2019-2020](image)

<table>
<thead>
<tr>
<th>Source: Naftogaz Group</th>
<th>2019</th>
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</thead>
<tbody>
<tr>
<td>Ukrtransgaz JSC</td>
<td>10</td>
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<tr>
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<td>6</td>
</tr>
<tr>
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</tbody>
</table>

![Number of injured employees in 2019-2020](image)

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<tr>
<th>Source: Naftogaz Group</th>
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<tr>
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<td>12</td>
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<td>Naftogaz JSC</td>
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</tr>
</tbody>
</table>

![Graph showing the number of victims of accidents by type of accident](image)

- Traffic accident
- Injuries caused by moving objects
- Injuries caused by falling persons
- Injuries caused by high temperature
- Contamination of a gas supplier
- Other

![Graph showing the number of injuries by their causes in 2018-2020](image)
Effective procurements

PROCUREMENT MANAGEMENT

The global pandemic due to COVID-19 and severe restrictions in Ukraine and beyond served as reasons for a slowdown in procurement processes both from the side of Naftogaz Group representatives and from the side of potential suppliers in 2020.

Despite this fact, in 2020, the Group’s entities managed to achieve significant results towards strengthening procurement efficiency, inter alia:

— commenced implementation of an automated procurement management system which would enable performance of procurements digitally. This opens the way to considerably simplifying procurement processes and optimising drawing-up, endorsement, and holding times;

— adapted internal regulations that standardise procurement activities in Naftogaz Group, in accordance with new wording of the Law of Ukraine “On Public Procurement”;

— improved the processes of document preparation and created documentation forms for procurements, as well as developed a memo for successful bid preparation by bidders. This makes it possible to engage more potential suppliers due to a clear preparation process of procurement information, and achieve significant cost savings;

— qualification criteria elaborated and recommendations for bidders drafted in the course of qualification criteria development, as well as bid evaluation criteria;

— the organisational form of Tender Committee meetings was changed and switched to online format, which under the quarantine restrictions ensured the preservation of proper efficiency levels;

— authorised persons dealing with simplified procurements identified and transition from work of Tender Committees to organisation of authorised persons in procedural procurement has begun;

— the introduction of a category management system and the formation of category teams which include top level experts who have a profound knowledge of market functioning, its specifics, and price quotations has begun. Naftogaz Group procurement procedures management is performed in line with internal corporate standards and the applicable laws of Ukraine. Clear communication during procurements between all structural subdivisions and Naftogaz Group companies is an important management element. For this purpose, in 2020, the Rules of Naftogaz structural subdivision interactions in goods, works, and services procurement were approved. Guidelines for the development of the Rules of Naftogaz Group structural subdivision interactions in goods, works, and services procurement were drafted. In addition, during 2020, the process of interaction of structural subdivisions during simplified procurements was developed and the method of ROIC flowsheets (responsibility matrix) used for the process of interaction of responsible subdivisions during the procurements was introduced. In 2020, changes in the approach to the organisation of the procurement system was a key event. The main goal of this transformation was to ensure greater transparency, to establish standardisation, and to increase the efficiency of procurement processes. As part of this process, the Supply Chain Management (SCM) project was initiated, which introduces a unified supply chain management system, including category management mechanisms. Based on preliminary assessments, the reform of the procurement function may result in savings of UAH 150 million.

Also during 2020, the detachment of the procurement control function began. The newly established independent contract boards and contracting departments at all levels of Naftogaz Group companies provide for supervision over the correctness of procurements. First of all, the independence of control is ensured in order to increase the transparency of procurement processes, to prevent anti-competitive behavior, and to increase the level of supplier trust. The main objective of the new controlling managerial bodies is to develop and implement a new management model of Naftogaz Group procurement contracts, which will ensure effective supply chain regulation, impartiality, and professionalism in decision-making on entering into procurement contracts.
best international standards and will enable combining all the procurement expertise of Naftogaz Group companies in one place, while ensuring direct and independent accountability to the Executive Board. Additionally, the new functional structure of procurement will increase the level of transparency of procurements, increase savings, and help attract the best suppliers from around the world.

RESULTS OF PROCUREMENT ACTIVITY

Following Naftogaz Group’s 2020 results, 5,761 procurements with a total expected value of UAH 53,244.99 million were announced. In general, the average number of bidders was 2.75.

In 2020, the Group’s companies placed 4,114 contracts worth UAH 34,305.00 million in ProZorro, 98.93% of which were entered into directly with residents. At the same time, 89% of the total procurement budget was spent on local suppliers registered in Ukraine. In 2020, the actual savings according to the results of trading amounted to UAH 2,276.40 million having increased by 39.42% versus 2019.

2021 PRIORITY GOALS:
— to finally replace Tender Committees with authorised persons for all Naftogaz Group procurements;
— to proceed with the digital transformation of the procurement process to increase efficiency through the targeted implementation of software systems that improve the speed and accuracy of business processes while minimising erroneous operations and decisions arising due to human factor;
— to complete the development of category strategies and create the necessary conditions for procurements in line with these strategies, which will increase savings;
— to boost the competitive environment in procurements and ensure successful (effective) procedures by Naftogaz Group companies;
— to promote a reduction in the number of contested procedures and requests for clarification from potential suppliers;
— complete the procurement transformation process throughout Naftogaz Group.
4. CORPORATE GOVERNANCE

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As Chair of the Nomination and Remuneration Committee, I am pleased to note that, following the Committee’s recommendations, the Supervisory Board of Naftogaz renewed the company’s Executive Board in January 2020, and the Ukrainian Government approved the decision to extend the contract of Chief Executive Officer, Andriy Kobolyev, for another four years in March 2020.

By taking this step, the Cabinet of Ministers of Ukraine has demonstrated its commitment to supporting the Ukrainian energy sector reforms and, in particular, the continuation of the transformation of Naftogaz led by Andriy Kobolyev and supported by the Supervisory Board, to increase its efficiency and effectiveness, and strengthen the Group’s ability to reach the objectives set by the shareholder.

However, at the same time, some personnel decisions may potentially adversely affect the continuity of the governance of the company: in particular, one of the members of the Supervisory Board appointed by the Government resigned and another does not participate in the work of the Supervisory Board. We hope that the government will soon add new qualified candidates which will duly perform the Supervisory board functions.

As Chair of the Audit and Risks Committee, I would mention the devastating impact of the COVID-19 pandemic and unprecedented price fluctuations in the energy market as the biggest challenges over the last year. The price of oil fell to historic lows at one point, while gas market prices also showed significant volatility, which complicated any strategic planning. In such difficult conditions, however, the Naftogaz Group continued to actively contribute to the development of Ukraine’s energy sector: Naftogaz entered the gas retail market, initiated the operations of the gas exchange and became an active player, extended its offers to customers, and made unprecedented use of Ukraine’s gas storage capabilities.

One of the biggest challenges we faced in 2020 came due to the levels of debt owed by regional gas supply companies and district heating providers to the Naftogaz Group. Gas was supplied during previous heating seasons by Naftogaz, which paid all applicable taxes but did not receive any subsequent payments from intermediaries. By the end of 2020, the debt of regional gas supply companies to Naftogaz of Ukraine NJSC amounted to UAH 23.5 billion, and the debt of district heating providers stood at UAH 40.9 billion.

We realize that a major part of this account receivable will never be repaid. This bad debt negatively affects the financial and legal capacity of Naftogaz to pay dividends. This point was strongly debated by the State Audit Service of Ukraine: the auditors paid no attention to the fact that the company received no payment for this gas.

We welcome the efforts of the Government of Ukraine to address the issue of settling bad debts to Naftogaz. A bill is currently being drafted to restructure the debt instead of writing it off, as some businesses have insisted. Both Naftogaz and its shareholder have an interest in recovering the money owed by gas customers.
Corporate governance

The approval of the Naftogaz of Ukraine Property Policy by the Government of Ukraine in 2020 was a milestone in the development of the company’s corporate governance system. This policy is one of the key documents required by the Organization for Economic Co-operation and Development (OECD) Guidelines for Corporate Governance of State-Owned Enterprises, as amended in 2015 (hereinafter OECD Guidelines), to define the purpose of state ownership, strategic goals and activities, which are determined by the shareholder.

Naftogaz of Ukraine’s Ownership Policy consolidated the obligation of the state to implement a corporate governance system in the company in accordance with OECD Guidelines. It also laid the foundations for the development and approval of Naftogaz Group’s corporate strategy, and established preparation for a minority IPO on a leading stock exchange as one of the company’s strategic goals.

Maintaining consistency in the implementation of best corporate governance practices and compliance with OECD standards is important. However, it is also important to avoid the use of documents such as the Property Policy to establish rules that are regulated by other legal mechanisms.

Just after the approval of the Property Policy in October 2020, the Ukrainian Government approved a new version of the Charter of Naftogaz of Ukraine1, which brought the company’s corporate governance system closer to the requirements of the OECD Guidelines.

In particular, in accordance with OECD Principles, approval of the company’s strategy and mission was transferred to the exclusive competence of the Supervisory Board. As a result, the Corporate Strategy of Naftogaz Group was approved in January 2021.

In addition, the Charter:
— enshrines the Naftogaz Group concept;
— reaffirms the status of the company as a legal entity of private law;
— determines that the key performance indicators of the Supervisory Board shall be approved by the General Meeting after consultation with the Supervisory Board;
— transfers internal controls, appointment and dismissal of the head of risk management, head of compliance, commissioner for anti-corruption program, financial controller, and approval of the relevant regulations from the Supervisory Board to the Board;
— restores the authority of the Board to approve the financial plans of legal entities where the company is the sole shareholder (founder, participant).

Additionally, the new Charter of the Company was brought into line with current legislation. In particular, the appointment and termination of powers of Board members, approval of the Board report, removal of the Chairman or board members from office, and appointment of acting Chairman of the Board are referred to the exclusive competence of the Supervisory Board.

At the same time, the Chairman of the Board shall be appointed and dismissed by General Meeting upon the proposal of the Supervisory Board submitted based on the decisions of the Supervisory Board on the Chairman’s election and termination.

The appointment of an auditor to conduct a statutory audit of the company’s financial statements, in respect of which there was a legislative conflict, has also been resolved.

However, Naftogaz Group corporate governance reform has not been completed. The Company has a long pathway of change ahead, and review of the legal framework regulating the distribution of powers between the governing bodies of state-owned companies is the precondition for the success of these reforms.

Further implementation of effective corporate governance in Naftogaz Group and other public sector companies is possible provided a number of important issues are addressed:
— empowerment of supervisory boards with the appropriate scope of authority, including approval of financial and investment plans;
— elimination of inconsistencies in legislation regarding the exclusive powers of the supervisory board with regard to appointment and dismissal of the Chairman of the Board;
— approval of a clear and transparent dividend payment procedure based on the results of the companies and enterprises of Naftogaz Group;
— preventing political interference in the management of state-owned companies and creating a level playing field for public and private companies;
— elimination of the existing ineffective controls by state bodies and ensuring appropriate internal controls.

All these and other subsequent actions related to the implementation of corporate governance reforms are expected to be performed by the Cabinet of Ministers of Ukraine, which administers the corporate rights of the state in the authorized capital of the company. Naftogaz Group is in regular communication with the Cabinet of Ministers of Ukraine, the Ministry of Economic Development, Trade and Agriculture, as well as other ministries, including with the participation of OECD representatives.

The ongoing transformation of the company and the legal entities within Naftogaz Group started in 2019. The transformation includes the launch of an efficient operational model with matrix management structure and appropriate distribution of powers and responsibilities for decision-making. In parallel with existing legal entities, new divisions and corporate functions are created within Naftogaz Group to ensure maximum efficiency in all its operational areas and achieve its corporate goals.
The year 2020 was full of unforeseen challenges and difficulties facing the global community. First, it brought changes in the personal composition of the supervisory board of Naftogaz.

In 2020, CMU elected a new government appointee, while one independent director left the supervisory board.

Pursuant to its Ordinance No. 293 dated 11 March 2020, the CMU elected Robert Bensh as government appointee on the supervisory board, his service agreement being executed by the Minister for Development of Economy, Trade and Agriculture of Ukraine on behalf of the company on 1 September 2020. However, during the reporting period, he did not complete the company’s onboarding and compliance requirements. Accordingly, he has not engaged in his supervisory board duties as of the date of this report. In particular, he did not attend any meetings of the supervisory board and its committees in 2020 and did not discharge any of his duties as member of the company’s supervisory board.

The unfortunate news was the decision of independent director Amos Hochstein to resign considering that he personally would no longer be able to serve as member of the supervisory board due to growing opposition in Ukraine to natural gas market reforms, transparency, good corporate governance, and Naftogaz’s transformation into an independent and efficient company. On 8 October 2020, the company received his resignation letter, and he left the supervisory board effective 12 October 2020. Members of the supervisory and executive boards of Naftogaz expressed their profound disappointment regarding the reasons that led Amos Hochstein to resign from the supervisory board.

In order to achieve the executive board in achieving strategic objectives set forth by Plan to Implement Strategic Plan of the Naftogaz Group Consolidated Business Plan for 2020-2024 and the Group, including amendments thereto, approval of the Naftogaz Group, including amendments thereto, the supervisory board elected new government appointee Robert Bensh by the Minister for Development of Economy, Trade and Agriculture of Ukraine in October 2020 which brought the company closer to the requirements of the OECD Guidelines on Corporate Governance and its committees were those pertaining to prior approval of executive board’s resolutions regarding operations of business companies of the Naftogaz Group, in particular ensuring approval of financial plans, amendments to charters related to the implementation of the matrix organizational structure in the Naftogaz Group, election and termination of authorities of their chief executives, approval of terms and conditions of contracts concluded with them, approval of entering into transactions which shall be subject to prior approval by the supervisory board, including a production enhancement contract and annex/additional agreements thereto, and production sharing agreements for the Buanska, Beserynyska, Balyklyyska, and Hainivka blocks.

Additionally, in 2020, the supervisory board reviewed and adopted resolutions on endorsement of draft financial plans of the company and individual business companies of the Naftogaz Group, including amendments thereto, approval of the Naftogaz Group, including amendments thereto, the supervisory board elected new government appointee Robert Bensh by the Minister for Development of Economy, Trade and Agriculture of Ukraine in October 2020 which brought the company closer to the requirements of the OECD Guidelines on Corporate Governance and its committees were those pertaining to prior approval of executive board’s resolutions regarding operations of business companies of the Naftogaz Group, in particular ensuring approval of financial plans, amendments to charters related to the implementation of the matrix organizational structure in the Naftogaz Group, election and termination of authorities of their chief executives, approval of terms and conditions of contracts concluded with them, approval of entering into transactions which shall be subject to prior approval by the supervisory board, including a production enhancement contract and annex/additional agreements thereto, and production sharing agreements for the Buanska, Beserynyska, Balyklyyska, and Hainivka blocks.

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The most frequent matters submitted by the executive board for consideration at meetings of the supervisory board and its committees were those pertaining to approval of executive board’s resolutions regarding operations of business companies of the Naftogaz Group, in particular ensuring approval of financial plans, amendments to charters related to the implementation of the matrix organizational structure in the Naftogaz Group, election and termination of authorities of their chief executives, approval of terms and conditions of contracts concluded with them, approval of entering into transactions which shall be subject to prior approval by the supervisory board, including a production enhancement contract and annex/additional agreements thereto, and production sharing agreements for the Buanska, Beserynyska, Balyklyyska, and Hainivka blocks.

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During 2020, the supervisory board adopted numerous resolutions on organizational changes in the company related to the optimization of business processes and organizational structure within the context of its ongoing transformation. With a view to increasing reserves and hydrocarbon production potential, the supervisory board resolved on the company’s participation in LLC Nadra Yuzivka.

The supervisory board and the management of the Naftogaz Group strongly welcomed adoption of the new Charter of Naftogaz in October 2020 which brought the company closer to the requirements of the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the “OECD Guidelines”) and meeting relevant corporate governance standards. Regrettfully, however, the CMU has not yet taken further steps to amend the Rules of Procedure of the supervisory board and the Rules of Procedure of the executive board to align with the requirements of the new Charter. Thus, as of the end
of the reporting period and as of the date of this report, these Rules of Procedure are not in compliance with the Charter of the company as well as in view of the expanded role of the audit department of Naftogaz Group in order to align it with the Annual Internal Audit Plan for 2020 and approved the internal audit department and, accordingly, amended the Charter of the company, to the executive board. Throughout the reporting year, the supervisory board focused substantially on ensuring the proper operation of the internal audit department and, accordingly, amended the Annual Internal Audit Plan for 2020 and approved the Annual Internal Audit Plan for 2021, as well as monitored its implementation. In addition, implementation of the new operating model within the Naftogaz Group necessitated the development of the internal control and the internal control department within the Naftogaz Group, which was also approved by the supervisory board in 2020. In December 2020, the supervisory board further approved amendments to the Regulations on the internal audit department of Naftogaz Group in order to align it with principles, requirements and manner specified in the Procedure for Conducting Audits of Financial and Business Operations of Naftogaz Group and requirements of the International Standards for the Professional Practice of Internal Auditing. Furthermore, considering the renewed mandate of the Charter of the company as well as in view of the expanded role of the corporate secretary in the Naftogaz Group’s corporate governance system, a review of the existing Regulations on the corporate secretary and the Corporate Secretariat of joint

Stock Company “National Joint Stock Company “Naftogaz of Ukraine” was also approved at the same meeting. According to the updated Regulations, the key areas of responsibility of the corporate secretary have been defined as liaising with shareholders of the company, in particular with the state as the shareholder in its capacity as the ownership entity, facilitating communication between the executive board, the supervisory board and shareholders of the company, including being a first point of contact on the matters in supervisory board proceedings, and its engagement with the executive board, the shareholder, and external stakeholders. In the reporting period, the supervisory board held several workshops led by Deloitte professionals from Deloitte’s Center for Corporate Governance to improve decision-making roles, responsibilities, and procedures related to the supervisory board, executive board, and corporate secretariat. As a result, Deloitte developed recommendations to improve corporate governance practices and assisted the supervisory board with self-assessment surveys. Naftogaz has identified follow-up actions to effectively address the findings from the self-assessment surveys. In particular, the chair of the supervisory board had individual feedback from each supervisory board member on the results of the supervisory board’s self-assessment.

**CONFlict of Interest**

During 2020, no conflict of interest has been disclosed by supervisory board members in relation to any agenda items.

**Supervisory Board Priorities**

During 2020, the supervisory board committed to using their best efforts to provide Naftogaz with the most effective supervision for prosperity of the company, delivering on the objectives set by the shareholder in the new ownership policy, and to the benefit of the people of Ukraine.

Given the acute concerns related to the adverse effect of the COVID-19 pandemic, the supervisory board’s priority in 2020 was to respond to its challenges and support the associated initiatives of the Naftogaz Group, which has actively engaged in addressing critical national issues, including prevention of the spread of COVID-19 and combating the tragic consequences of the pandemic. Despite the challenges confronting the global business community during the year, the supervisory board fully encouraged the efforts undertaken by the Naftogaz Group’s management to implement the corporate transformation plan and ultimately create a far more agile, modern and efficient company committed to delivering the best outcomes to the benefit of Ukraine.

In view of the above, as well as considering the preparation of the company for an initial public offering of its minority stake on one of the leading stock exchanges, the supervisory board considered its mission to ensure stable and effective leadership in the context prevailing in the global economy and in the energy markets as particularly critical during this reporting period. Therefore, a new executive board team was set up, through effective joint efforts of the supervisory board and the shareholder, arrangements were made to extend the tenure of the chief executive officer for another four years, viewed as crucial for needed business continuity in critical times. The new executive board is now a very strong team, with great and extensive experience. It already has and continues to deliver significant results in these challenging times.

Furthermore, other issues extensively reviewed by the supervisory board in the reporting period included matters pertaining to the company’s dividend policy towards the company, compensation to Naftogaz for supplying gas under the public service obligations in the natural gas market, and ensuring payment of accumulated tax debt of PSC “UKRNAFTA”. Members of the supervisory board held numerous strategic sessions as part of the development of the Naftogaz Group Corporate Strategy, which was approved in January 2021, in accordance with the objectives and business directions set by the ownership policy. The supervisory board further placed greater emphasis on ensuring the proper functioning of the internal controls, inter alia, follow-up on internal audit objectives, regular updates on TOP risks of the Naftogaz Group, as well as redesigning and significantly strengthening the compliance function.

**SHAREHOLDER AND EXTERNAL COMMUNICATION**

During 2020, there were 15 general meeting resolutions adopted regarding the company. The COVID-19 pandemic changed the format of supervisory board’s communication with the shareholder and key stakeholders during 2020. However, the supervisory board used every chance to liaise with the CMU and relevant ministries to exchange views and reach mutual alignment on the most critical aspects of Naftogaz Group’s operations like prospects of the corporate governance reform, bringing the company’s Charter in line with the OECD Guidelines, approval of the revised ownership policy, setting of key performance indicators for the supervisory board and implementation of new projects for increasing reserves, field development and natural gas production.

Close cooperation with the CMU during the reporting year resulted in adoption of decisions related to ensuring the continuity of the company’s management, distribution of the company’s profits for 2019, etc. The supervisory board looks forward to further close cooperation and open communication with the CMU going forward.

Most noticeably, the quarantine restrictions imposed in late Q1 2020 halted regular personal encounters with representatives of international stakeholders.

**COMPETENCE AND PROCEEDINGS OF THE SUPERVISORY BOARD’S COMMITTEES**

**Audit and Risks Committee**

Key functions of the committee

In line with the current Regulations on the audit and risks committee of the supervisory board, the key task of this committee of the supervisory board is to assist the supervisory board and the board of directors in the exercise of their duties in the interests of the company’s interests by preparing drafts and providing recommendations and proposals regarding:

1. competence and proceedings of the supervisory board and the board of directors; and
2. effectiveness of the internal accounting and financial control system of the company;
3. effectiveness of the company’s risk management activities;
4. selection, appointment, performance and ongoing work of the external (independent) auditor;
5. selection, appointment, reappointment and dismissal of the chief audit executive, performance and ongoing work of the internal audit department; and
6. treasury arrangements in place for the company.

In accordance with the above task, the committee performs the following functions:

1. To organize and perform preliminary review of the matters included into the agendas of the committee and the supervisory board meetings, and related to finance, audit and risk management;
2. To organize and elaborate on drafting of conclusions, proposals, recommendations, other documents, draft policies, strategies, rules of procedure, procedures, decisions related to finance, audit and risk management, and submit them for supervisory board’s review;
3. To organize and perform the following functions related to financial statements to:
1) monitor and review the integrity, completeness, accuracy and timeliness of the preparation of financial information of the company;
2) review with the management of the company and the external auditor the summary financial statements, as well as justification and acceptability of applied principles of financial statements, and any material correction of the statements;
3) review the completeness and consistency of all changes to accounting methods and the accounting policy along with how these changes affect the content of the statements, according to the company and its subsidiaries;
4) consider any significant differences between the external auditor and management regarding the company’s financial statements.

4. To organize and perform the following functions related to internal controls and risk management to:
- review at least annually the overall state and efficiency of the company’s internal control and risk management systems, including review of reports of the external and internal auditors;
- review the effectiveness of corrective actions taken by the management with respect to improvement of the system of internal control and risk management;
- meet regularly with the executive board of the company to review significant risks and issues of control and planning.

5. To organize and perform the following functions related to external audit of the company to:
- make recommendations to the supervisory board and, where appropriate, to the general meeting on the appointment, reappointment or removal of the external auditor, the audit fee and the terms of engagement of the external auditor, study issues that may be deemed as the reason for dismissal of the external auditor and answer any questions of resignation or dismissal relating to the external auditor;
- control compliance with the Law of Ukraine “On Public Procurement” and other applicable legislation in the selection of the external auditor;
- control independence and objectivity of the external auditor in line with International Accounting Control, Auditing, Review, Other Assurance, and Related Services;
- establish and apply an official definition of a policy, types of services that are not subject to audit, and which are excluded or permitted after the committee's review or permissible without the recommendation of the committee;
- develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm;
- review efficiency of processes of the external audit, the nature and scope of the audit, monitor the audit and review any problems or reservations arising from the audit, the responsiveness of the management to written recommendations, and review the findings of the audit with the external auditor, including but not limited to the discussion of any major issues which arose during the audit, including:
- any accounting and audit judgments;
- levels of errors identified during the audit.

6. To organize and perform the following functions related to internal audit of the company to:
- submit for approval by the supervisory board the Regulations on the internal audit department;
- make recommendations to the supervisory board on the appointment, reappointment or removal of the chief audit executive;
- make recommendations to the supervisory board on terms of labour agreements which are being concluded with the internal audit department staff (including with the chief audit executive);
- prepare the draft budget of the supervisory board, including the budget of the internal audit department, and submit it for approval by the supervisory board;
- submit the annual plan of risk-oriented internal audits for approval by the supervisory board;
- review reports on the activities of the internal audit department;
- review at least annually the performance and effectiveness of the internal audit department;
- consider issues that prevent the internal audit department from effective performance of its tasks, and help eliminate such restrictions;
- ensure sufficient and adequate resources for the effective performance of the internal audit department.

7. To organize and perform the following functions related to the supervisory board of the company to review and report to the supervisory board the overall management of treasury activities in the company, including:
- banking arrangements and relationships;
- liquidity management and forecasting;
- debt management;
- interest rate risk management;
- treasury internal control.

8. To organize and perform other responsibilities in the company, including:
- initiate and conduct special investigations as needed, including involving independent consultants (experts);
- consider cases of fraud and assess the adequacy of measures taken in management to prevent fraud;
- consider the need for amendments to the Regulations on the committee;
- provide recommendations on the selection, appointment, reappointment and dismissal of the head of the budgeting unit;
- provide the supervisory board with the report on the committee’s activity at least once every six months, as also, upon supervisory board’s demand, regular reports or information on certain matters of the committee’s activity;
- submit for review by the supervisory board draft new versions of the Regulations on the committee or necessary amendments and additions thereto with the respective substantiation;
- perform other duties related to the committee’s competence when requested by the supervisory board.

Key functions of the committee

In line with the current Regulations on the ethics and compliance committee of the supervisory board, the key task of this committee is to assist the supervisory board in protection of the company's interests by evaluating and providing recommendations and proposals regarding:
- 1) effective implementation and application of the Code of Corporate Ethics in the company;
- 2) amendments to the Code of Corporate Ethics as mandated by the company's mission and strategy in the changing operative environment;
- 3) monitoring and elimination of one-off and recurring violations of the Code of Corporate Ethics by the company's officers and employees;
- 4) specific rules and procedures for handling of third-party complaints related to ethics breaches committed by the company's officers and employees; and
- 5) appropriate means to mitigate negative consequences caused by ethics breaches committed by the company's officers and employees.

The committee focuses on compliance and conformance with the Code of Corporate Ethics to ensure that a consistent framework of business conduct expectations is in place, including:
- ensuring ethical decision-making, compliance with the laws in the jurisdictions in which the company operates as well as conformance with internal company standards;
- fostering of an open culture of reporting underpinned by the company's policies to ensure non-retaliation, conducting investigations and addressing violations;
- facilitating set up of the whistleblowing lines or other mechanisms to allow employees to raise their ethics-related concerns; and
- ensuring that employees are provided with adequate means to raise and handle their complaints.

In pursing its tasks and functions, the committee is entitled to:
- elaborate and draft decisions and conclusions, proposals, recommendations, policies, strategies, rules of procedure, procedures, other documents related to corporate ethics, and submit them for supervisory board's approval;
- initiate and implement appropriate monitoring tools to survey compliance with the Code of Corporate Ethics within the company;
- make recommendations to the supervisory board regarding matters pertaining to the chief compliance officer's appointment and dismissal and matters of setting up and assessment of performance on objectives and key performance indicators of the chief compliance officer;
- receive and review the reports of the chief compliance officer and make recommendations to the supervisory board regarding the measures, which may need to be taken based on the results of consideration of such reports and outcomes of investigations and audits;
- initiate or conduct internal investigations and audits;
- hold meetings with the company's executives and employees;
- facilitate set up of the whistleblowing lines or other mechanisms for the company's employees as well as other persons to raise their ethics-related concerns;
- facilitate training of solar activities for the company's staff on ethics-related issues;
- have access to reports on alleged ethics-related breaches, oversee subsequent actions by the company's officers in charge;
- consider issues that prevent the internal audit department from effective performance of its tasks, and help eliminate such restrictions; and
- ensure sufficient and adequate resources for the effective performance of the internal audit department.

Key results in 2020

In 2020, the audit and risks committee held 14 meetings, adopted more than 60 resolutions on agenda items, and considered more than 10 matters that were submitted for discussion. The committee considered its most important action in 2020 as helping the company to react quickly to the unprecedented crisis of that very particular year.
Key results in 2020
In 2020, the ethics and compliance committee held 4 meet-

ings, adopted 3 resolutions on agenda items, and considered

more than 5 matters that were submitted for discussion. The

major focus of the committee's work in 2020 was to enhance

the role of chief compliance officer which has been critical for

ensuring that the company is better equipped to ensure good

ethics and behaviours throughout the Naftogaz Group.

Key functions of the committee
In line with the current Regulations on the nomination and
evaluation of candidates and also, upon supervisory board’s
recommendations to the executive board on these issues;
21) making an annual report to the supervisory board on the
activities, including those that lead to significant legal
consequences;
6) integration of HSE and Reserves into major business
processes, including capital programs, exploration
programs, mergers and acquisitions, and expanding into
new markets;
7) external disclosures of information relating to HSE and
Reserves;
8) quality of HSE and Reserves management, and
appropriateness of methods and measures for achieving
the main goal and making the appropriate management
decisions;
9) creating favourable conditions for attracting investments
to increase the production of hydrocarbons.
2. Review the rating and position of the company with respect
to international best practice for HSE and Reserves, and legal
requirements on these issues, including relevant corporate
governance developments.
3. Advise the supervisory board on the aforementioned matters.
Key results in 2020
In 2020, the nomination and remuneration committee held 14 meetings, adopted more than 50 resolutions on agenda items, and considered more than 6 matters that were submitted for discussion. Smooth operation and protection of employees across the Naftogaz Group in times of the global COVID-19 crisis is the biggest challenge of 2020 and beyond has been, and currently is, at the core of the committee’s attention since the outbreak of the pandemic.

STRATEGY COMMITTEE
Key functions of the committee
In line with the current Regulations on the strategy committee of the supervisory board, the key task of this committee is to support the supervisory board in:
1) fulfilling its oversight responsibilities relating to the Naftogaz Group Corporate Strategy development;
2) guiding the Naftogaz Group in formulating a consolidated business plan that is consistent with the Naftogaz Group Corporate Strategy;
3) proposing long-term performance metrics and targets for the chief executive officer, chief audit executive, chief compliance officer, and performance of the executive board and provision of the executive board’s recommendation;
4) ensuring comprehensive monitoring of progress by the Naftogaz Group in delivering on the corporate strategy and consolidated business plan against goals, strategic milestones and performance objectives;

COMMITTEE ON HEALTH, SAFETY, ENVIRONMENT AND RESERVES
Key functions of the committee
In line with the current regulations on the committee on health, safety, environment and reserves of the supervisory board, the key tasks of this committee are as follows:
1. Examine and prepare for consideration by the supervisory board the items of agenda with regard to the exercise of control over the strategy to achieve the HSE plans and related risk assessment in the context of the overall business strategy of the company;
2. Scope and focus of policies and action plans prepared for support of delivery of the HSE and Reserves strategy, including mitigation of related risks;
3. implementation of plans and controls in relation to HSE and Reserves strategy, implementation of plans and measures, including emergency and accident (incident situation) response plans;
4. review of major and recurring failures within the company in terms of HSE and Reserves governance and performance and its influence on general economic activities, including those that lead to significant legal consequences;
5. In line with the current Regulations on the committee of the supervisory board, the key tasks of this committee are as follows:
1) support the supervisory board in:
2) ensuring continuity of the executive board;
3) In 2020, the committee on health, safety, environment and reserves held 13 meetings, adopted 3 resolutions on an agenda item, and considered a strategic plan that was submitted for discussion. Smooth operation and protection of employees across the Naftogaz Group in times of the global COVID-19 crisis is the biggest challenge of 2020 and beyond has been, and currently is, at the core of the committee’s attention since the outbreak of the pandemic.
In accordance with the above task, the committee performs the following functions:

1) general oversight of the executive board work on the strategic perspective and direction of development of the Naftogaz Group and its businesses;
2) prior review and endorsement of the Naftogaz Group Corporate Strategy and preparation for consideration by the supervisory board of the recommendations as to its approval;
3) prior review and endorsement of the Naftogaz Group Consolidated Business Plan and preparation for consideration by the supervisory board of the recommendations as to its approval;
4) identification and communication with the supervisory board and the executive board of the long-term performance metrics and targets for the company and Naftogaz, as well as of the strategic risks;
5) prior review and preparation for consideration by the supervisory board of strategic matters brought for consideration of the supervisory board by the executive board or the general meeting;
6) regular discussion and provision of related opinions, recommendations for the supervisory board as well as ensuring their realization in the area of:
   - strategic initiatives of the executive board, including exit from existing lines of business and entry into new lines of business, joint ventures, acquisitions, investments, dispossession of business and significant assets, business expansions and diversification;
   - corporate governance, risk appetite, financial and capital planning and resources, and whether the above can support the company’s and Naftogaz Group’s strategic objectives;
   - overall impact of changes in the regulatory and competitive environment on the Naftogaz Group Corporate Strategy and strategic initiatives of the executive board;
7) annual review of the Naftogaz Group Corporate Strategy and Consolidated Business Plan execution progress against the corporate goals, financial and operational targets, guidance to the supervisory board and the executive board on addressing shortfalls;
8) oversight of the executive board's implementation of major transformation projects and their execution.

Key results in 2020

In 2020, the strategy committee held 2 meetings, adopted 1 resolution on an agenda item, and considered more than 5 matters that were submitted for discussion. In the reporting year, the committee was the key driver behind the development of strategic initiatives which led the foundation for the Naftogaz Group Corporate Strategy approved shortly afterwards.
Risk management in Naftogaz Group in 2020

In 2020, Naftogaz Group continued its comprehensive efforts to improve risk culture and risk management. As part of steps to establish a new risk management system:

- centralized Naftogaz Group Risk Management Corporate Function has been set up
- Naftogaz Group Risk Management Policy and Regulations approved
- risk significance criteria determined and quarterly assessment of the most significant risks of the Group with identification of risk owners has been introduced
- coordination between risk management action plans development and implementation launched
- monitoring of the Naftogaz Group risk profile introduced with regular reporting to the executive board and the supervisory board

Impact of COVID-19

The spread of COVID-19 and the introduction of quarantine measures resulted in significant uncertainties during 2020. Most national companies have faced a large number of challenges, which have created additional risks compared to the normal course of business. The operations of the Naftogaz Group were impacted by the pandemic, including its operating activities, due to the introduction of quarantine measures, reduction of consumer and business activity, drop in demand, and decline in the price of natural gas, oil and condensate products. First and foremost, due to COVID-19, personnel were exposed to significant risks, jeopardizing the continuity of company operations.

To mitigate these risks, Naftogaz Group took a number of prompt steps that ensured the company’s normal operations. The staff of the group were provided with the requisite personal protective equipment; most employees not involved in the production process have been transferred to remote work; additional safety measures have been introduced to protect the health of our employees.

To ensure its financial stability and continuous smooth operations, Naftogaz Group has accelerated the company transformation process. To that end, it implemented a new operational model, improved approaches to the evaluation and selection of investment projects, and optimized its cost structures and capital management.

Strategic Risks

Prolongation of the company’s obligation to sell gas through regional gas supply companies (obligazubut) and district heating providers (DHP) due to the extension of the Regular on Assigning Special Obligations (PSO) by the courts.

During 2020, the Regular on Assigning Special Obligations to Naftogaz of Ukraine NISC was still effective in Ukraine. According to this Regulation, the company was obliged to sell and supply natural gas to households till August 2020 (as amended), and to DHPs throughout 2020. This resulted in the accumulation of bad accounts receivable. At the end of 2020, the debt of DHPs and CHPs to Naftogaz of Ukraine was almost UAH 47.4 billion, and the debt of the regional gas distribution companies was about UAH 24.1 billion.

To mitigate the impact of the risk on liquidity and profitability, Naftogaz Group implemented effective bad debt collecting and debt restructuring mechanisms in order to optimize cash flows, reduce the level of credit risk, and decrease financial losses.

Additionally, thanks to effective cooperation with public authorities and the shareholders at the end of 2020, the Group received compensation of UAH 32.2 billion for the sale of imported gas for households in 2015-2019 at a price below the market price under PSO.

Operational Risks

Depletion of existing deposits and insufficient level of hydropower reserves replacement.

Most of the existing deposits where the Group operates are highly depleted (70%-80%), which leads to a constant decline in hydropower extraction. The state regulation of gas prices, delays in issuing new licenses, and a number of other restrictions have led to insufficient investment in exploration of promising new fields and an increase in proven gas reserves.

In 2020, thanks to fruitful cooperation with the Ukrainian Government, the Group received promising new licenses on the Black Sea shelf and in the Yuzivska area. The successful exploration and development of these areas would quintuple the Group’s estimated production capacity up to 600 bcm. In addition, Naftogaz Group signed a memorandum of understanding on cooperation with Romanian company OMV Petrom, the leading integrated energy company in Southeastern Europe. The two companies will cooperate in the implementation of gas exploration and production projects on the Black Sea shelf.

Risk of losses due to accidents, unauthorized withdrawal of resources, and forced interruption in the operation of production facilities.

The oil and gas transmission system of Naftogaz Group includes a large number of onshore production facilities and communications which collectively constitute an extensive structure. As a result, these facilities are vulnerable to natural disasters such as fires, frosts, earthquakes, floods, droughts and hail. For example, large-scale fires in October 2020, which covered large areas of Luhans region, led to a temporary halt in production at three fields.

Unauthorized extraction of oil and condensate by third parties is a significant problem for Naftogaz Group companies. Prolonged tapping leads to equipment damage and, in turn, to repair expenses. In 2020, about 30 illegal connections to oil and condensate pipelines were detected and eliminated. This resulted in almost UAH 1 million in losses for the Group.

To ensure effective monitoring over the oil and gas transmission system and condensate pipelines, Naftogaz Group has established a Monitoring Center. The center hosts an intelligent surveillance system, which enables real-time data processing. Data is provided by engineering safeguards systems, video surveillance systems, unmanned aerial vehicles, and other sources. Thanks to this new surveillance system, the situation at Group facilities can be fully controlled, potential risks can be predicted, and adequate proactive measures can be taken.

Decrease in volumes and revenues from the sale of natural gas.

A natural gas surplus in domestic and European markets (accumulation of natural gas in underground storage facilities, including by traders in the customs warehouse model), increasing competition, partial shift to other fuels, the impact of COVID-19, and an economic downturn have all led to a significant drop in natural gas prices. The weighted average price of natural gas in 2020 was 25% less than in 2019, and sales of natural gas decreased by more than 7% compared to the previous year.

To mitigate the risk, Naftogaz Group decided to sell 80% of the retail market and play the role of its key driver. The Group actively promoted the development of exchange trade in natural gas. It also expanded the range of goods and services provided without prepayment to offer the best conditions for its customers and increase natural gas sales.

Financial Risks

Liquidity risk

Liquidity risk is caused by a number of interrelated factors, including:

- the need to pay dividends in favor of the state in accordance with time schedules set by the Cabinet of Ministers;
- seasonality of expenses and income of Group enterprises;
- accumulation of bad debts for supplied natural gas;
- fixed deadlines for repayment of loans to banks.

To mitigate risk, Naftogaz Group made a number of steps during 2020 aimed at optimizing its operating and capital expenditures, while also improving the efficiency of operating activities and capital management. As a result, total actual capital investments in 2020 grew at half the planned rate, and the company invested in projects with the highest added value. Due to improvements, the Group’s cash flows were optimized and it fully repaid its liabilities to the state and banks.

Environmental, Occupational Safety and Health Risks

As with any other company in the oil and gas sector, the employees of Naftogaz Group companies are exposed to occupational safety and health risks. Unforeseen emergencies not only lead to the loss of production capacity and the suspension of operations, but also environmental impacts and the impacts on health and the lives of employees.

In order to mitigate environmental impact and prevent injuries and accidents among employees, staff of Naftogaz Group regularly undergoes specialized training to comply with national and international standards for safe and healthy working conditions.
5. CORPORATE SOCIAL RESPONSIBILITY

- Local community development
- Environmental protection
- Energy efficiency
DEVELOPMENT STRATEGY LESS BASELINE ENABLES ARRIVAL AT NET STRATEGY EFFECTS

Baseline:
D&G sector only sustains currently developed fields in 2021 - 2030

— Naftogaz's greenfield projects are halted, while brownfield projects are intensified. Private companies continue to develop perspective fields

— As the wells in operation at the analysis date are not able to sustain current depletion, OPEX, CAPEX, and natural gas production will decline resulting in negative spillover effects for the Ukrainian economy

— The share of imports in natural gas supply grows up to 70 percent

— If the Development strategy is not implemented, negative effects are not limited to import growth but also include job cutting (with a subsequent reduction in salary spending), and a reduction in expenses (which hits suppliers’ business)

Net strategy:
development projects for new fields

Development strategy:
energy independence by 2030

— Implementation, along with baseline operation, of a complex of projects, which may result in gradual natural gas import substitution in Ukraine from 2021 to 2030

— The energy independence strategy may be implemented either by Naftogaz or conjunction with private market participants (the effects may vary depending on CAPEX efficiency, sequence of projects etc.)

CUMULATIVE EFFECTS 2021 - 2030

1. Gross domestic natural gas production, bcm

2. GDP: UAH bn

3. Domestic output: UAH bn

4. Fiscal revenue: UAH bn

5. Jobs; thousand

DEVELOPMENT STRATEGY LEADS TO ENERGY INDEPENDENCE

Operational inputs

| Trade gas production | Cumulative 2021 - 2030 | Baseline | Development strategy
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>2021</td>
<td>18.6 UAH bn</td>
<td>30 UAH bn</td>
<td></td>
</tr>
<tr>
<td>2030</td>
<td>248 UAH bn</td>
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UAH 1 invested in natural gas production yields long term effects on:

GDP 2.86 UAH bn

Fiscal revenue 1.19 UAH bn

Domestic output 5.72 UAH bn

Social activities under the Development strategy 2021 - 2030

Local residents

- Health facilities: 468 UAH bn
- Education: 468 UAH bn
- Infrastructure: 624 UAH bn
- Others: 433 UAH bn

12.5 million people

Forecast investment in social and infrastructure projects 2.0 UAH bn

Direct effect of projects on local residents 22.6 UAH bn

- Health facilities: 7.0 UAH bn
- Education: 0.5 UAH bn
- Infrastructure: 10.5 UAH bn
- Others: 4.5 UAH bn

Social activities: Local residents and infrastructure projects

* Base values are accepted at the level of 2018, as of the most recent year for which input Output table is available as per Ukarstat Numbers may not add up due to rounding.
Local community development

Support for local community development in the regions where Naftogaz Group companies operate is one of our priorities. Every year, the companies of the Group invest in social and infrastructure projects, provide charitable assistance to communities, and make rental payments to local budgets.

Approach to interaction with local communities

Naftogaz Group operates in more than 12 administrative regions of Ukraine including 250 communities. The company is conscious of the importance of considering the interests and needs of a wide range of stakeholders.

In 2020, Naftogaz Group joined the UN Global Compact Network, the world’s largest corporate sustainability initiative. The company selected three UN Sustainable Development Goals to focus its social investment on in 2020.

To increase the efficiency and effectiveness of its social investments, Naftogaz Group developed and implemented a project approach to the implementation of social infrastructure and charitable projects. An internal Corporate Social Responsibility Committee established the Corporate Social Responsibility Standard for Relations with Communities, Charitable Organizations and NGOs was approved. This standard aims to achieve all-round support for regional development. It determines the approach to cooperation and communication with communities, charities, NGOs and other non-profit organizations, and establishes decision-making procedures for financing projects of various scales.

In 2020, the company, in its communication with local communities, was guided by the Stakeholder Engagement Framework, which was developed and approved in 2019. The company is open to feedback from local communities. Inquiries and suggestions can be delivered either via a feedback form on the company’s official website, or by calling the number of the Regional Development Department. The Regional Development Department is in the head office of the company and the relevant units of its branches are responsible for replying to queries and settling any issues concerning relations with local communities.

Naftogaz Group is engaged in high-tech hydrocarbon production activities in areas close to the local communities. Such activities have a permissible impact on the environment and community life in accordance with norms established by law. While implementing its production projects in local communities, the Company pays special attention to communication and cooperation with communities to inform them about planned activities and increase their level of tolerance of production operations.

In addition, Naftogaz Group informs the public about the specifics of its planned activities and prospects for the social and economic development of communities during public discussion of the Environmental Impact Assessment (EIA) Report. In 2020, Urengoydobudannya initiated the process of publishing reports on the social and economic impact of Urengoydobudannya’s operations in the National Unified EIA Register. In 2020, Urengoydobudannya received 12 EIA expert opinions for construction (drilling) of wells and 34 expert opinions for the extension, expansion of boundaries or amendments to special permits for subsoil use and their special terms.

Social investments of Naftogaz Group

During 2020, Naftogaz Group disbursed over UAH 21 million and implemented about 60 social infrastructure projects. The social investments made by Naftogaz Group in the development of local communities promote sustainable development and comfortable living conditions, improve healthcare services, create modern education space in schools, and provide opportunities for the comprehensive and diverse development of children and adults.

Naftogaz Group provides regular support to Ukrainian military units in the eastern Ukraine war zone. In 2020, Urengoydobudannya, in partnership with the Relief Center Charitable Foundation, provided necessary household items, materials and instruments to three military units in Sumy, Poltava and Donetsk regions. The total value of this assistance...
CSR projects for regional development

**GOOD HEALTH AND WELL-BEING**

- Providing the outpatient clinic with basic office equipment
- Pyshnenky village, Zinkiv district, Poltava region

- Upgrading the local hospital
- Komyshnia village, Komyshnia town, Poltava region

- Creating comfortable environments for medical staff
- Volanska village, Pyshnenky district, Poltava region

- Buying oxygen equipment for the Myrhorod central district hospital
- Myrhorod village, Myrhorod district, Poltava region

- Major repair of the rural medical post
- Kolchak village, Poltava district, Kharkiv region

**RESPONSE TO COVID-19**

- 287 hospitals in 19 regions of Ukraine
- 500 thousand protective suits
- 700 thousand masks
- 50 mobile digital x-ray machines
- 50 mobile ultrasound machines

- 19 hospitals in Kyiv and Cherkasy regions
- 43 thousand masks
- 50 thousand respirators
- 1000 of disinfectants

**QUALITY EDUCATION**

- In partnership with the Education Ministry, delivered to all regions education departments in Ukraine:
- 3.2 million medical masks
- > 20 thousand liters of disinfectants
- 1 200 thousand respirators
- > 220 thousand protective suits
- 920 thousand medical masks

**SUSTAINABLE CITIES AND COMMUNITIES**

- Equipping the state-of-the-art physics classroom
- Lanna village, Pyshnenky district, Poltava region

- Major repair of the local hospital
- Karyshki village, Karlivka district, Kharkiv region

- Buying a new ECG machine for the rural medical post
- Vitalk village, Kotelva district, Poltava region

- Equipping the gym
- Karlivka village, Karlivka district, Kharkiv region

- Providing households with high quality drinking water
- Troilivka village, Matliash district, Poltava region
Charitable assistance provided by Naftogaz Group under the Caring About Protection project in 2020

UAH 653 million

COVID-19 charitable assistance within the framework of Caring About Protection projects in 2020

Charitable assistance provided by Naftogaz Group

In the context of the COVID-19 pandemic, Naftogaz Group has been actively involved in supporting local communities. The company has launched a large-scale Caring About Protection project, aimed at mitigating the impact of the COVID-19 pandemic. In 2020, Naftogaz allocated UAH 653 million within the framework of the project to support healthcare institutions and residents of areas where the company operates. The project activities included:

- Reconstruction and equipment of a gym in the village of Krasiivka, Poltava region, in partnership with the KERNEL group of companies.
- Support to hospitals – the project purchased and transferred medical equipment, repair of lung ventilators – 49 ventilators in 39 hospitals across 14 regions of Ukraine.
- Safe external independent testing – 24 regional and Kyiv city departments of education.
- Charitable support to communities – 236 communities in 11 regions of Ukraine.
- Support for the People’s House in the village of Ohrivkivskyi and the village of Voroblyevychi, Lviv region, in cooperation with the MHP Group of Companies.
- Implement more than 130 social infrastructure projects in 2 communities of Lviv region. A common approach based on the experience of each of the partners contributed to the prompt solution of urgent community problems in the common areas of presence. In particular, the premises of the school and kindergarten in the village of Voroblyevychi were refurbished and the building of the People’s House in the village of Ohrivkivskyi was reconstructed.
- Charity of Partnership and Sustainable Development project in 2 communities.
- 5.0% of sales of food supplies to regional specialized hospital in Sumy, central district hospitals in Ochikryvka, Hadiach, Varva and Pryuky, and to the Rashivka psychoneurological nursing home.
- Charitable assistance provided by Ukrnafta to local communities in 2020 reached a total of UAH 2.6 million. Ukrnafta 227.5 thousand was transferred to Ukrvaktsina SE reporting to the Ministry of Health of Ukraine. As a result, 14,000 liters of fuel were provided for the transport of personal protective equipment to healthcare workers throughout Ukraine. Ukrnafta also donated UAH 240 thousand to buy protective respirators for the Dolyna general hospital, the primary care center of the Dolyna District Council, and the Rozhrutiv central district hospital.
- Besides that, in May-June 2020, Naftogaz gas production units Oktymyranftogaz, Pottavantafzash and Chernihivnaftogaz delivered 3 tons of food supplies to the regional specialized hospital in Sumy, central district hospitals in Ochikryvka, Hadiach, Varva and Pryuky, and to the Rashivka psychoneurological nursing home.
- In March 2020, the Verkhovna Rada of Ukraine made amendments to the Tax Code, which exempted taxpayers from land tax, land rent, and real estate tax for March 2020. The changes were made to support taxpayers for the period of coronavirus disease preventive measures. However, Ukrnafta kept on paying taxes and transferred UAH 17 million to local budgets. The taxes contributed to improving the financial situation of local communities during a surge in healthcare spending.
- In 2021, Naftogaz Group operates (240 projects).
- 5.0% of sales of food supplies to regional specialized hospital in Sumy, central district hospitals in Ochikryvka, Hadiach, Varva and Pryuky, and to the Rashivka psychoneurological nursing home.
- Charity of Partnership and Sustainable Development project in 2 communities.
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More information about local community support projects is available on the site:

https://csr.ugv.com.ua/
Naftogaz Group environmental protection activities are regulated by the Environmental Safety Policy approved in 2020. The provisions of this Policy stipulate that the Group shall:— protect and mitigate adverse environmental impact;— raise the level of environmental culture and awareness in employees and legal entities of the Naftogaz Group regarding their role in helping to solve environmental problems;— ensure effective functioning of the environmental management system in compliance with international standard ISO 14000 "Environmental Management Systems";— increase the efficiency of production processes by using the best available technologies;— adhere to the principle of dynamic economic development subject to the most rational use of natural resources etc.

Naftogaz Group measures adopted to reduce negative impact on the environment are meticulously developed and approved by internal regulations. The company was guided them by the following programs and plans in 2020:

— Goals in environmental protection and actions to achieve them;
— Environmental and Social Action Plan developed under a loan agreement with the International Bank for Reconstruction and Development;

Environmental protection

Naftogaz Group conducts regular internal environmental audits at its entities in order to support and improve the efficiency of environmental management systems. These actions are carried out in compliance with international standards ISO 14001:2015, ISO 19011:2018 and ISO 7127-2:2007/ISO 7127:2019 (1) "Environmental protection. Environmental Audit in National Joint Stock Company “Naftogaz of Ukraine”). The purpose of the revision and update of the standard was to introduce a vertically integrated corporate function of environmental protection management across Naftogaz Group. In addition, institutional transformation of the company requires development of new standards aimed at the introduction and support of a continuous and effective process of improving the environmental performance of production processes and ensuring a high level of environmental protection at all stages of life cycle.

During the reporting period, the company remained active in cooperation under the Memorandum of Understanding on reduction of fugitive methane emissions in Ukraine’s gas supply chains signed by the EBRD, Ministry of Ecology and Natural Resources, and Naftogaz in 2018. A methane volume measurement campaign went through its second stage and systematic approach to methane emissions reduction was adopted in order to implement the Methane Emission Reduction Program along the entire gas supply chain (upstream, midstream, downstream).

In 2020, the decision was made to develop a Process Equipment Replacement Roadmap and Investment Program, the implementation of which will reduce methane leaks across Group entities.

Within the framework of Naftogaz Group environmental safety, the use of the R programming language and specialized software libraries was introduced to analyse monitoring data, model the state of ecosystems, and visualise data. The use of specialized technologies of analytical data processing can significantly increase the coverage and level of detail in environmental risk assessment. In addition, works were ongoing in 2020 to update data in the consolidated geospatial working environment; work also began on the exchange of environmental geospatial data between subdivisions within the Group in order to promptly identify risks at all production stages.

Laboratories of Ukrtransgaz, Ukrtransnafta and Ukrugasvydobuvannya conducted cross-check measurements of actual NOx and CO concentrations (mg/m³) and mass emission (g/h) under operations, and approaches to rational use of natural resources and environmental protection. During 2020, employees of the company took part in a range of internal and external trainings and workshops:

— Training “Non-financial reporting per GRI standards: Monitoring reporting and verification (MRV) of greenhouse gas emissions”.

Environmental protection costs in 2018-2020, UAH million

<table>
<thead>
<tr>
<th>Year</th>
<th>Current costs</th>
<th>Capital investments</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>166.0</td>
<td>2.1</td>
</tr>
<tr>
<td>2019</td>
<td>178.9</td>
<td>2.1</td>
</tr>
<tr>
<td>2020</td>
<td>264.7</td>
<td>2.1</td>
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**KEY ACHIEVEMENTS IN THE FIELD OF ECOLOGY AND ENVIRONMENTAL PROTECTION IN 2020**

1. Naftogaz Group has joined the global voluntary industrial initiative related to implementing an enhanced system of methane emissions monitoring, reporting, and mitigation, Oil and Gas Methane Partnership 2.0 (OGMP 2.0). The updated OGMP 2.0 initiative applies to the full cycle of oil and gas production, as well as to the transportation and refining phases that are often overlooked. The extended data obtained is expected to provide a clearer understanding of the climate impact of the oil and gas industry and help develop the most effective solutions aimed at major reduction of methane emissions over the next decade. Naftogaz Group estimates its commitments under the OGMP 2.0 initiative to be discharged over 2021-2026.

2. During 2020, preparations were made for the implementation of a procedure for monitoring, reporting, and verification (MRV) of greenhouse gas emissions in line with Law of Ukraine No. 388-IX of 12 December 2019 “On the principles of monitoring, reporting and verification of greenhouse gas emissions” and Resolution of the Cabinet of Ministers of Ukraine No. 960 dated 23 September 2020. Training, practical meetings, and online workshops were held in order to train the responsible persons in theory and practical implementation of MRV procedures at production facilities.

3. The Environmental and Radiological Safety Section independently revised the first version of SOU 71.2-2007720-079-2017 “Environmental protection. Environmental Audit in National Joint Stock Company "Naftogaz of Ukraine”. The purpose of the revision and update of the standard was to introduce a vertically integrated corporate function of environmental protection management across Naftogaz Group. In addition, institutional transformation of the company requires development of new standards aimed at the introduction and support of a continuous and effective process of improving the environmental performance of production processes and ensuring a high level of environmental protection at all stages of life cycle.

4. During the reporting period, the company remained active in cooperation under the Memorandum of Understanding on reduction of fugitive methane emissions in Ukraine’s gas supply chains signed by the EBRD, Ministry of Ecology and Natural Resources, and Naftogaz in 2018. A methane volume measurement campaign went through its second stage and systematic approach to methane emissions reduction was adopted in order to implement the Methane Emission Reduction Program along the entire gas supply chain (upstream, midstream, downstream).

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8. In 2020, a methane volume measurement campaign went through its second stage and systematic approach to methane emissions reduction was adopted in order to implement the Methane Emission Reduction Program along the entire gas supply chain (upstream, midstream, downstream).

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13. In 2020, a methane volume measurement campaign went through its second stage and systematic approach to methane emissions reduction was adopted in order to implement the Methane Emission Reduction Program along the entire gas supply chain (upstream, midstream, downstream).
standard conditions, and standard oxygen content at nominal load of process equipment at different stages of the process. The purpose of these measurements was to develop and approve process standards for gas turbines and engines used in the oil and gas industry of Ukraine with a rated thermal output of 1 to 50 MW. The above actions were implemented in the framework of implementation of provisions of Directive 2010/75/EU "On industrial emissions (integrated pollution prevention and control)" and Directive (EU) 2015/1218 "On the limitation of certain pollutants into the air from medium combustion plants", which regulates pollutant emissions from plants with a rated thermal output of 1 MW or above, and under 50 MW.

Implementation was ongoing for equipment upgrade and maintenance projects, which made it possible to reduce leaks and in-house consumption of natural gas, namely:
- repair and replacement of emergency-prone pipeline sections, audit, repair and replacement of safety breathing valves of tanks and devices;
- corrosion control, electrochemical protection, intelligent pigging of pipelines;
- introduction of technologies for repairing defective sections without releasing gas from the pipeline; construction of a closed-loop oil processing system, upgrade of flare systems.

**Investments in the Environment**

In 2020, Naftogaz Group invested UAH 128.3 m into activities aimed at mitigation of any negative eco-impacts and environmental conservation, among which 75.8% was directed into mitigating any negative eco-impacts and environmental conservation. Non-methane volatile organic compounds (NMVOC) and other non-methane volatile organic compounds were the most significant pollutants in Naftogaz Group activities totaling UAH 0.6 m or 52.0% of cumulative current costs of Naftogaz Group.

In the context of fund usage, the most Naftogaz Group funds were targeted at wastewater purification (41.6%) and soil protection and re-soiling (12.2%). 9.1% of cumulative current costs were designated for research and development works, 7.2% for measures on atmospheric air protection, 3.7% for waste handling, and 2.0% for radiation and security provision. Other focuses included measures on mitigation of noise and vibration impact, the preservation of biodiversity, and natural sites protection. In 2020, Naftogaz Group spent UAH 22.5 m on this group of measures.

During 2020, Naftogaz Group had 57 inspections on compliance with ecological safety requirements by the relevant state bodies and their territorial subdivisions. Based on these inspection findings, Naftogaz Group entities paid fines cumulatively amounting to UAH 213,000.

In 2020, Naftogaz Group entities paid UAH 44.8 m of environmental tax that is 52.3% less than in the previous year. This decreased amount is explained by the unbundling of LLC "Operator of Gas Transmission System of Ukraine" from Naftogaz Group. Over half of the total amount of environmental tax (UAH 25.4 m) was paid by Ukrtransgaz. By tax categories, the largest payment by Naftogaz Group was exercised for pollutant emissions from fixed sources, equalling 90.0% of the total amount.

**Pollutant Emissions**

- Methane (СН4): 171.9 ktons of СО2-equivalent
- Nitrogen compounds (N2O): 22.4 ktons of СО2-equivalent
- Non-methane volatile organic compounds (NMVOC): 16.6 ktons of СО2-equivalent
- Sulphur compounds (SO2): 7.7 ktons of СО2-equivalent
- Organic compounds (CO): 6.2 ktons of СО2-equivalent

**Structure of greenhouse gas emissions into the atmospheric air by Naftogaz Group in 2020**

**Environmental Pollution Cases in 2020**

Substantial risks of industrial environmental pollution are caused by unauthorized interventions into pipeline transport facilities of Naftogaz Group entities in order to steal hydrocarbon raw materials. On top of material losses, such illegal actions lead to fires and accidents that can leak hydrocarbons into soil and water bodies (more detailed information is available in the "Health and labour safety" section).

Another common cause of environmental pollution incidents is loss of containment (ruptures, corrosion) of pipelines and other equipment. In 2020, 54 cases of land contamination with a total area of 4,342.5 m² were recorded, including one significant contamination of agricultural land and forest plantations with an area of approximately 4,100 m². Contamination was caused by oil spraying due to loss of containment of surface equipment of well No. 64 of Shidniv-Rohyntsiivske field of PJSC UKRNAFTA due to the breakdown of a polished rod. The company informed the land owner and liquidated the accident aftermath.

**MITIGATION OF IMPACT ON ATMOSPHERIC AIR**

Reduction of pollutant emissions. Pollutan emissions generated by Naftogaz Group entities are accounted in line with Article 10 of the Law of Ukraine "On The Atmospheric Air Protection". In 2020, Naftogaz Group managed to achieve a significant reduction of pollutant emissions into the atmosphere in comparison with the previous year. The total emission volume was equal to 31.1 kt, which is 59.0% lower than in 2019.
Structural subdivisions of Naftogaz Group entities meet the requirements stipulated by the conditions of permits for pollutant emissions and carry out industrial control over the state of atmospheric air at the border of the sanitary protection zone and instrumental and laboratory measurements of the parameters of pollutant emissions. Work is regularly carried out to maintain the facilities, equipment, and apparatus for purification of pollutant emissions in working order within the timeframe specified by the Order of the Ministry of Ecology No. 52 dated 6 February 2009.9 Most gas-cleaning plants are used to purify the gas and dust stream from dust particles (dry mechanical dust collectors, dry inertial collectors). At least twice a year, gas cleaning plants are reviewed to assess their technical condition.

The company has an Environmental and Radiological Safety Section which is responsible for filling out the state statistical reporting form10 and submitting it to the territorial body of the State Statistics Service of Ukraine. At Naftogaz Group entities, this role is performed by the relevant ecology services.

6 By mandate of the Ministry of Ecology and Natural Resources of 06.02.2009 No 52 “On approval of the Rules of technical operation of gas purification plants”

6 Pursuant to the approved document “Goals and tasks in the area of environmental protection and measures to achieve and implement them” of Naftogaz Group, the key task of the company in the area of water resources management is to reduce water consumption each year by 4%. The Company has a separate structural subdivision responsible for water use and water disposal.

7 Volume of reused and multi-used water in 2020 amounted to 4,404.5 tcm. In terms of Naftogaz Group companies, this amount represents 17.2% of total water withdrawal.

8 Production and technology needs; drinking water and sanitary engineering needs

9 At Naftogaz Group companies, the total volume of waste management services amounted to 1,232.7 thousand tons of waste, most of which (89.0%) belong to low-hazardous waste (Class III). Second came moderately hazardous waste (Class II), which amounted to 13.4 thousand tons or 10.2% of the total. Particles of extremely hazardous Class I and highly hazardous (Class II) levels were insignificant at 0.1% and 0.9% respectively. In terms of Naftogaz Group companies, Ukrgasvydobuvannya and Ukrnafta have generated the largest volume of waste at 88.2% and 30.0% of the total area respectively.

10 Mandate of the Kyiv City executive body dated October 12, 2011 No 1879 “On approval of the Rules of wastewater acceptance of subscribers into the sewerage system of the city of Kyiv"
In terms of wastewater quality categories, the following was discharged out of the total volume in 2020:

- 4.0 tcm with insufficient treatment
- 2.2 tcm clean wastewater based on regulation (without treatment)
- 145.1 tcm of treated wastewater under the regulations at the treatment facilities by means of biological treatment
- 182.7 tcm with the help of mechanical treatment

During 2020, in the administrative building of National Joint Stock Company “Naftogaz of Ukraine”, within the framework of the Green Office project, the following was collected and handed over for recycling:

- 0.58 tons of paper waste to specialised enterprises (processing plants and cardboard and paper mills)
- 0.05 tons of waste batteries to enterprises that have a license to conduct business in the management of hazardous waste
- 0.054 tons of fluorescent lamps and waste that contains mercury

The structure of waste generated in 2020 by types, %:

- Waste treatment plants (excluding objects other than greenhouse complexes) 5.5%
- Water bodies 24.5%
- Hazardous waste (I-III class), kt 12.2%
- Ferrous and non-ferrous scrap 9.3%
- Mixed household waste 51.6%
- Others 1.2%

Practical work on the elimination of contamination of soils and water bodies with oil and petroleum products is carried out in line with the provisions of SOU 74.2-2007/7720-84: 2018 “Environmental protection. Elimination of contamination of soils and water bodies with oil and oil products. Rules”, approved in 2018. In October 2020, geophysical research of groundwater contamination in the northern part of the Mashivskyi district was performed. Based on research results, the outlines of the spread of free oil products on the horizon of groundwater and the zone of spread of oil products in the soils of the aeration zone were specified. In addition, during the reporting period, Naftogaz Group has initiated measures to restore networks of observation wells to monitor the quality of groundwater at the production sites of Group companies.

**Biodiversity Conservation**

In 2020, Chornomornaftogaz developed the “Emerald Network Facility Management Plan: Wetland Eastern Svisloch” (“The Management Plan”) to implement environmental conditions following the assessment of the environmental impact of planned activities. The Management Plan is related to the Strilkove Gas Field, which is located on the territory of the Emerald Network of Europe13, an area with facilities of special ecological interest. The Management Plan comprises a list of species of flora, fauna, and their natural habitats that are located on the territory of Chornomornaftogaz. The main purpose of the Management Plan is to develop special measures to maintain populations of species and their natural habitats that will meet environmental, scientific, and cultural requirements and practices. Special measures shall include: establishment of a monitoring system aimed at assessing the integrity of the facility and the condition of ecosystem and facilities included in the list of ecological networks; timely detection of adverse changes and forecasting their possible development; development of appropriate forecasts and recommendations for the preservation of the ecological network.

During 2020, independent experts carried out monitoring research on animal populations, vegetation, and landscape complexes on the territory where Ukrnafta operates. This research was performed in accordance with the terms of the relevant conclusions on the assessment of the environmental impact and confirmed the absence of major adverse effects on local ecology.

In addition, in 2020, Naftogaz Group continued to monitor the interaction of the company’s licensed areas with the facilities of the Environmental Protection Fund and the Emerald Network of Ukraine. The purpose of this work is up-to-date detection of environmental risks associated with Naftogaz Group production activities.

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13 The Emerald Network of Europe was created in accordance with the Bern Convention on the Conservation of European Wildlife and Natural Habitats (1979)
Energy efficiency

Energy efficiency management

Efficient consumption of fuel and energy in production processes is one of the key priorities of Naftogaz Group’s development strategy. Company activities in this area are guided by the energy management policy approved in 2017. Naftogaz Group has an energy management system in place, which is part of an integrated management system and meets the requirements of the ISO 50001 Energy Management Systems standard.

Energy use

In the reporting period, Naftogaz Group enterprises consumed a total of 1.2 million toe of fuel and energy to satisfy the technological needs of extraction, preparation, and storage of natural gas and oil, including:
- 0.9 bcm of natural gas;
- 0.9 billion kWh of electricity;
- 84.4 thousand tons of oil (gas condensate);
- 207.7 thousand toe (tons of oil equivalent) of other types of energy (boiler and furnace fuel).

The decrease in energy consumption in 2020 by Naftogaz Group enterprises (down 62.3% on 2019) was due to the separation of the gas transmission system operator of Ukraine into a structure which is independent of the Naftogaz Group – Ukraine GTS Operator LLC.

Production and technological energy use in 2020, %

Use of fuel and energy in 2016-2020, million toe

1.2

Share of fuel and energy savings in the total fuel and energy consumption in 2016-2020, %

Results of energy saving measures

During 2020, the implementation of energy saving and energy efficiency initiatives by Naftogaz Group resulted in a reduction of its energy consumption by 18.0 thousand toe.

The total cost of saved fuel and energy in 2020 amounted to UAH 147.7 million (including VAT).

Production and technological fuel and energy costs in 2020

<table>
<thead>
<tr>
<th>Naftogaz Group companies</th>
<th>Total energy thousand oil equivalent</th>
<th>Natural gas mcm</th>
<th>Electricity million kWh</th>
<th>Thermal energy thousand Gcal</th>
<th>Other types of energy thousand toe</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ukrtransgaz</td>
<td>79.2</td>
<td>92.6</td>
<td>16.7</td>
<td>23.0</td>
<td>0</td>
</tr>
<tr>
<td>Ukrgasvydobuvannya</td>
<td>517.1</td>
<td>584.0</td>
<td>253.5</td>
<td>182.1</td>
<td>1.7</td>
</tr>
<tr>
<td>Ukrnafta</td>
<td>541.8</td>
<td>241.8</td>
<td>481.2</td>
<td>193.8</td>
<td>406.3</td>
</tr>
<tr>
<td>Ukrtransnafta</td>
<td>10.6</td>
<td>0.4</td>
<td>115.3</td>
<td>7.9</td>
<td>0.3</td>
</tr>
<tr>
<td>Ukravtogaz</td>
<td>2.9</td>
<td>1.9</td>
<td>13.4</td>
<td>2.7</td>
<td>0</td>
</tr>
<tr>
<td>Ukrpetrostransgaz</td>
<td>0.3</td>
<td>0.0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.4</td>
</tr>
<tr>
<td>Chornomornaftogaz</td>
<td>0.2</td>
<td>0.3</td>
<td>0.0</td>
<td>0.0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>1,152.1</td>
<td>920.9</td>
<td>880.3</td>
<td>409.6</td>
<td>408.7</td>
</tr>
</tbody>
</table>
In terms of the company’s enterprises, the largest contribution to the reduction of overall energy consumption in production processes was made by Ukrnafta and Ukrgasvydobuvannya – 6.6 thousand toe and 8.0 thousand toe, respectively. They are followed by Ukrtransgaz (2.5 thousand toe) and Ukrtransnafta (0.8 thousand toe).

As a result of the implementation of the Naftogaz of Ukraine Energy Efficiency Improvement Program for 2015–2020, the reduction of energy consumption decreased by 8.5 thousand toe in the reporting period. At the same time, the implementation of sectoral energy saving programs by enterprises resulted in 9.5 thousand toe savings of fuel and energy.

In 2020, Naftogaz of Ukraine NJSC completed the implementation of its Energy Efficiency Improvement Program for 2015–2020. The objectives of the Program were to achieve fuel and energy savings of 625 thousand toe including: 718 mcm of natural gas, 89 million kWh of electricity, and 169 thousand Gcal of thermal energy. The efforts of Naftogaz Group to implement the program action plan over 5 years resulted in total savings of 704 thousand toe, including:

<table>
<thead>
<tr>
<th>Energy Type</th>
<th>Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electricity</td>
<td>85 million kWh</td>
</tr>
<tr>
<td>Thermal energy</td>
<td>516 thousand Gcal</td>
</tr>
<tr>
<td>Natural gas</td>
<td>763 mcm</td>
</tr>
<tr>
<td>Total</td>
<td>704 thousand toe</td>
</tr>
</tbody>
</table>

Energy efficiency projects

In order to achieve the goals of the Naftogaz of Ukraine NJSC Energy Efficiency Program for 2015–2030, the enterprises of Naftogaz Group have implemented activities and projects that promote the economical use of fuel and energy in production processes and in households.

Affordable Heat Project

During 2020, Naftogaz-Energoservice SE continued the implementation of a project to improve energy efficiency in households and municipal buildings. Activities within the framework of the project included installation and repairs of heating and water supply systems in apartments in 75 residential buildings, namely:

- 56 buildings in Kropyvnytskyi city;
- 2 buildings in Alexandria town;
- 17 buildings in Svitlovodsk town.

The company also inspects facilities for further installation of individual heating systems. As of the end of 2020, more than 240 subscribers have shown an interest in the reconstruction and installation of individual heating systems. In addition, Naftogaz-Energoservice SE actively cooperates with the Kropyvnytskyi City Council on the implementation of a city heating system optimization program.

Goals and plans for 2021

- Improvement of the Company Energy Management System in line with the requirements of the ISO 50001:2018 international standard.
- Approval of the Naftogaz Group Energy Efficiency Improvement Program for 2021–2025.
- Development of new energy service products and services for end users and, potentially, bringing them to the market.
- Development and approval (as appropriate) of the Naftogaz Group Natural Gas Market Target Model and metric systems for the purposes of market analysis.
6. FINANCIAL OVERVIEW AND STATEMENTS
The global spread of COVID-19 created significant volatility, uncertainty, and economic disruption during 2020. The pandemic has resulted in widespread adverse impacts on the global economy and continues to impact gas demand and prices. Last summer gas prices were at a record low in Ukraine. In this volatile and unpredictable year, we have demonstrated Naftogaz’s resilience through the Covid-19 pandemic. I would like to thank the Naftogaz team, who have kept our plants running and energy flowing to Ukraine.

Naftogaz reacted quickly and decisively to protect our people, operations and balance sheet. By doing so, we reduced costs significantly, enhanced liquidity and preserved long-term asset values. While this necessitated difficult decisions, it has shown that we are resilient. We are making progress with our transformation process and enhancing our efficiency. Capital discipline is key in our industry. Affordability of investments is an important consideration when making investment decisions. Priority has been given to maintaining production at existing fields. At the same time, with the help of international partners who bring new technologies and cost-effective solutions to Ukraine, we will ensure our medium-term growth and de-risk new onshore and offshore greenfield opportunities.

We are advancing our strategy to become the energy partner of choice, and to unlock the potential of the Ukrainian energy market. We continue to grow our gas business, the main generator of profit and cash flow, and to build our business to consumer business. In 2020 our low cost, scalable retail model was successfully launched. Further liberalization of the household segment offers Naftogaz growth potential. Finally, we have started to establish our low carbon business. Ukraine is well positioned for various low carbon solutions; hydrogen is a key example where our gas resources, infrastructure and storage opportunities provide a competitive advantage.

Our income went from UAH 2.6 billion in 2019 to a loss of UAH 19.0 billion in 2020, which included material provisions for bad debts. Our underlying profit, excluding provisions for bad debts and other unusual items, was robust at UAH 5.2 billion. Integration with the European market provides Ukrainian consumers the same opportunities that consumers in EU countries experienced for the previous 15 years, leading to lower natural gas prices. After abolishment of the Public Service Obligations (PSO) for gas retail companies on 1 August 2020, Ukrainian gas consumers can switch freely from gas suppliers and benefit from market-based pricing, whilst gas intermediaries pay for gas supplies. However, payments for deliveries made before 31 July 2020 under the PSO remain outstanding which results in material provisions for bad debts, about UAH 23.2 billion in the year, which negatively impacts our profitability and operating cash flow. Finally, in December government provided compensation for gas deliveries under the PSO during 2015 to 2019. The amount of compensation was UAH 26.4 billion after tax.

Our ability to generate cash remains strong. Operating cash flow was UAH 19.5 billion, more than double the operating cash flow of UAH 6.9 billion in 2019 despite a challenging environment. The total contribution paid to the State Budget amounts to UAH 141.0 billion. A dividend of UAH 39.6 billion was paid in 2020 and a dividend of UAH 8.5 billion was prepaid late 2019. In March 2021, Fitch affirmed Naftogaz’s “B” rating with a stable outlook.

I believe that Naftogaz has come out stronger from the downturn, and I look to the future with confidence. We are transforming Naftogaz with a focus on building a new performance-oriented culture, promoting personal accountability, and boosting efficiency across the group. As ever, thank you for your continued support!

Petrus Stephanus van Driel
Naftogaz Group CFO
SUMMARY OF RESULTS:
— The underlying profit for the full year, excluding provisions for bad debts and other unusual items, was UAH 3.2 billion*.
— The company has entered into a period of improved profitability with an expected underlying profit in the first quarter of 2021.
— After abolishment of the Public Service Obligations (PSO) on 1 August 2020, Ukrainian gas consumers can switch freely from gas suppliers and benefit from market-based pricing, whilst gas intermediaries pay for gas supplies. However, payments for deliveries made before 31 July 2020 under the PSO remain outstanding which results in material provisions for bad debts, UAH 23.2 billion in the year, which negatively impacts our profitability and operating cash flow.
— In December government provided compensation for gas deliveries under the PSO during 2015 to 2019. The amount of compensation was UAH 26.4 billion after tax.
— Impairment of assets was UAH 8.0 billion (2019: UAH 9.4 billion), reflecting revised price assumptions.
— For 2020, operating cash flow was UAH 19.5 billion, more than double the operating cash flow of UAH 6.9 billion in 2019 despite a challenging environment. Operating cash flow for the Q4 2020 was UAH 3.4 billion, compared with a operating cash flow of UAH (10.0) billion in Q4 2019.
— In 2020 gross gas production was 15.4 bcm and 18.2 bcm of gas was sold.
— Capital expenditure was UAH 15.0 billion, below the target of UAH 20 billion and 46% lower than 2019.
— Free cash flow was resilient at UAH (3.4) billion. It included the purchase of State treasury bonds. In March 2021 an amount of UAH 11.5 billion matured and was returned to the Group.
— Net debt reduced from UAH 42.6 billion at the end of 2019 to UAH 29.2 billion at the end of 2020.
— Total contribution paid to the State Budget amounted to UAH 141.0 billion. A dividend of UAH 39.6 billion was paid in 2020 and a dividend of UAH 8.5 billion was prepaid late 2019.
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— Total contribution paid to the State Budget amounted to UAH 141.0 billion. A dividend of UAH 39.6 billion was paid in 2020 and a dividend of UAH 8.5 billion was prepaid late 2019.
Ukrnafta’s result was positively impacted by higher volumes of crude oil sold and lower fines and penalties in respect of outstanding tax liabilities as they were settled during 2020.

Other segments include results the gas transit services, joint operations under the concession agreement for exploration and development in Egypt, corporate capital investment activities of the Group, low carbon solutions and other activities. The result was negatively impacted by impairment losses recognised in respect of accounts receivable on Egyptian product sharing agreement.

**CONTRIBUTIONS TO THE STATE BUDGET**

In 2020, the Group transferred UAH 141.0 billion of taxes and dividends to the State Budget, including UAH 25.2 billion of corporate income tax.

The Group paid dividends of UAH 39.6 billion (excluding UAH 8.5 billion of interim dividends paid in 2019), or 95% of the 2019 net profit.

The Group remains one of the largest net contributors to the State Budget of Ukraine.

**Cash flow**

UAH 19.5 bn

despite harsh conditions, operating cash flow in 2020 more than doubled compared to 2019

**Gross gas production in 2020**

15.4 bcm

**Gas sales in 2020**

18.2 bcm

**Capital expenditure in 2020**

46 %

deeper than 2019

**Net debt**

UAH 29.2 bn

Net debt reduced from UAH 42.6 billion at the end of 2019 to UAH 29.2 at the end of 2020
Joint Stock Company
“National Joint Stock Company
“NAFTOGAZ OF UKRAINE”

Consolidated Financial Statements
as at and for the Year Ended
31 December 2020

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Why the matter was determined to be a key audit matter

DETERMINING THE FAIR VALUES OF PROPERTY, PLANT, AND EQUIPMENT

The Group applies revaluation model for its property, plant and equipment. As discussed in Note 5 “Property, Plant, and Equipment” to the consolidated financial statements, the latest revaluation of property, plant and equipment was made as at 1 December 2020 and as at 31 December 2020 based on the valuation report of independent professional appraiser. As a result of revaluation, the Group recognized the revaluation decrease in the total amount of UAH 17,863 million (including UAH 1,974 million of impairment loss in the profit or loss and UAH 15,889 million of loss on revaluation in other comprehensive income).

ACCOUNTING OF LOSS ON DISPOSAL OF SUBSIDIARY AND FAIR VALUE ASSESSMENT OF CONSIDERATION RECEIVABLE AT INITIAL RECOGNITION AND AS AT 31 DECEMBER 2020

As discussed in Note 2 “Operating environment” and Note 20 “Discontinued operations and Consideration receivable under the SPA” on 1 January 2021 100% owned subsidiary was disposed under a sale and purchase agreement (“SPA”) based on terms of fixed payment and regular variable payments for 15 years.

Management concluded that results from the sale of subsidiary in the amount of UAH 8,336 million should be recognized directly in equity in the consolidated financial statements for the year ended 31 December 2020. The fair value of the variable consideration receivable was determined as at 1 January 2020 by the Group’s management and 31 December 2020 based on the valuation report of independent professional appraiser in the amount of UAH 8,336 million and UAH 81,058 million, respectively.

The accounting of loss on disposal of subsidiary and determination of the fair value of consideration receivable is a key audit matter since the transaction is complex and
non-routine, involves significant management judgements as to the accounting treatment and high level of subjectivity of assumptions used in the fair value model. In addition, fair value model is highly sensitive to such assumptions as the annual volumes of gas transit and transit terms, amount of balancing services, regulated asset base tariffs and the discount rate.

Refer to Note 2 “Operating environment”, Note 20 “Discontinued operations and Consideration receivable under the SPA”, Note 23 “Fair Values”, Note 26 “Critical Accounting Estimates and Judgments” for further details.

Why the matter was determined to be a key audit matter

higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

— Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group’s internal control.

— Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

— Conclude on the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the Group to cease to continue as a going concern.

— Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

— Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the supervision, and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit. We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters described with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period, and are therefore the key audit matters. We describe these matters in our auditor’s report, unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Other Information

Management is responsible for the other information. The other information comprises the information included in the management report prepared in accordance with the article 11 of the Law on accounting and financial reporting and the article 40 of the Law of Ukraine “On Securities and Stock Exchange Market”, which also includes corporate governance report, but does not include the consolidated financial statements and our auditor’s report thereon, which we obtained prior to the date of this auditor’s report, and the annual report, which is expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appear to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor’s report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

When we read the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs and Law on accounting and financial reporting, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group’s financial reporting process.

Responsible for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with IASs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with IASs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

— Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is
### CONSOLIDATED STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED 31 DECEMBER 2020

<table>
<thead>
<tr>
<th>Note</th>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>NET PROFIT</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total expenditure</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Loss)/profit before income tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income tax expense</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share of after-tax results of associates and joint-ventures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign exchange gain</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total expenditure</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net (loss)/profit for the period from continuing operations</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discontinued operations:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit for the period from discontinued operations</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net (loss)/profit</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net (loss)/profit is attributable to:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Owner of the Company from:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Continuing operations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discontinued operations</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Non-controlling interest from:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Continuing operations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discontinued operations</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net (loss)/profit</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Other comprehensive (loss)/income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Items that will not be reclassified subsequently to profit or loss, net of income tax:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss on revaluation of property, plant and equipment, net of income tax benefit of UAH 3,572 million (2019: income tax benefit of UAH 12,722 million)</td>
<td>(15,889)</td>
<td>(57,929)</td>
</tr>
<tr>
<td>Share of other comprehensive income of associates, net of income tax effect of nil (2019: nil)</td>
<td>-</td>
<td>133</td>
</tr>
<tr>
<td>Remeasurement of defined benefit obligation, net of income tax effect of UAH 125 million (2019: UAH 113 million)</td>
<td>592</td>
<td>(1,020)</td>
</tr>
<tr>
<td>Remeasurement of decommissioning liability (net of income tax effect of UAH 82 million (2019: UAH 175 million)</td>
<td>371</td>
<td>(1,710)</td>
</tr>
<tr>
<td><strong>Items that may be reclassified subsequently to profit or loss, net of income tax:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign currency translation reserve</td>
<td>729</td>
<td>(687)</td>
</tr>
<tr>
<td>Other comprehensive loss</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total comprehensive (loss)/income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total comprehensive (loss)/income is attributable to:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Owner of the Company from:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Continuing operations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discontinued operations</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total comprehensive (loss)/income</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2020

<table>
<thead>
<tr>
<th>Note</th>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>271,134</td>
<td>340,506</td>
</tr>
<tr>
<td>Investments in associates and joint ventures</td>
<td>7,685</td>
<td>10,439</td>
</tr>
<tr>
<td>Deferred tax assets</td>
<td>63,432</td>
<td></td>
</tr>
<tr>
<td>Consideration receivable under the SPA</td>
<td>6,039</td>
<td>8,505</td>
</tr>
<tr>
<td>Other non-current assets</td>
<td>9,375</td>
<td></td>
</tr>
<tr>
<td>Prepaid corporate income tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total non-current assets</strong></td>
<td>298,437</td>
<td>260,285</td>
</tr>
<tr>
<td>Current assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td>28,129</td>
<td>59,056</td>
</tr>
<tr>
<td>Trade accounts receivable</td>
<td>22,641</td>
<td>9,487</td>
</tr>
<tr>
<td>Prepayments made and other current assets</td>
<td>702</td>
<td>263</td>
</tr>
<tr>
<td>Prepaid corporate income tax</td>
<td>37,106</td>
<td>77,593</td>
</tr>
<tr>
<td>Cash and bank balances</td>
<td>659</td>
<td>436</td>
</tr>
<tr>
<td>Restricted cash</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assets of discontinued operations classified as held for sale and distribution</td>
<td>115,355</td>
<td></td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td>147,554</td>
<td>320,295</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>445,991</td>
<td>580,580</td>
</tr>
<tr>
<td><strong>EQUITY</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share capital</td>
<td>194,307</td>
<td>194,307</td>
</tr>
<tr>
<td>Revaluation reserve</td>
<td>140,171</td>
<td>316,264</td>
</tr>
<tr>
<td>Foreign currency translation reserve</td>
<td>4,069</td>
<td>3,340</td>
</tr>
<tr>
<td>Accumulated deficit</td>
<td>(37,801)</td>
<td>(123,244)</td>
</tr>
<tr>
<td><strong>Equity attributable to owners of the Parent</strong></td>
<td>310,746</td>
<td>390,677</td>
</tr>
<tr>
<td><strong>Non-controlling interest in equity</strong></td>
<td>3,535</td>
<td>1,497</td>
</tr>
<tr>
<td><strong>TOTAL EQUITY</strong></td>
<td>314,281</td>
<td>392,574</td>
</tr>
<tr>
<td><strong>LIABILITIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borrowings</td>
<td>56,547</td>
<td>47,148</td>
</tr>
<tr>
<td>Provisions</td>
<td>9,853</td>
<td>10,588</td>
</tr>
<tr>
<td>Deferred tax liabilities</td>
<td>12,910</td>
<td>18,858</td>
</tr>
<tr>
<td>Other long-term liabilities</td>
<td>3,564</td>
<td>2,691</td>
</tr>
<tr>
<td><strong>Total non-current liabilities</strong></td>
<td>82,064</td>
<td>79,285</td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borrowings</td>
<td>9,795</td>
<td>13,514</td>
</tr>
<tr>
<td>Provisions</td>
<td>13,576</td>
<td>42,841</td>
</tr>
<tr>
<td>Trade accounts payable</td>
<td>3,585</td>
<td>5,061</td>
</tr>
<tr>
<td>Advances received and other current liabilities</td>
<td>20,277</td>
<td>19,494</td>
</tr>
<tr>
<td>Corporate income tax payable</td>
<td>1,843</td>
<td>10,471</td>
</tr>
<tr>
<td>Liabilities of discontinued operations classified as held for sale and distribution</td>
<td></td>
<td>17,340</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td>49,046</td>
<td>108,721</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES</strong></td>
<td>131,710</td>
<td>188,006</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES AND EQUITY</strong></td>
<td>445,991</td>
<td>580,580</td>
</tr>
</tbody>
</table>
CASH FLOWS FROM OPERATING ACTIVITIES

<table>
<thead>
<tr>
<th>Description</th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss/profit before income tax from continuing operations</td>
<td>(14,042)</td>
<td>4,891</td>
</tr>
<tr>
<td>Profit before income tax from discontinued operations</td>
<td>20</td>
<td>77,360</td>
</tr>
<tr>
<td>Adjustments for:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation of property, plant and equipment and amortisation of</td>
<td></td>
<td></td>
</tr>
<tr>
<td>intangible assets</td>
<td>16,548</td>
<td>34,439</td>
</tr>
<tr>
<td>Loss on disposal of property, plant and equipment and intangible assets</td>
<td>505</td>
<td>847</td>
</tr>
<tr>
<td>Impairment of property, plant and equipment and intangible assets</td>
<td>2,950</td>
<td>10,230</td>
</tr>
<tr>
<td>We've drawn of inventories</td>
<td>8</td>
<td>96</td>
</tr>
<tr>
<td>Net movement in provision for trade accounts receivable, prepaid assets</td>
<td>42,697</td>
<td>21,683</td>
</tr>
<tr>
<td>Fair value remeasurement of financial assets</td>
<td>321</td>
<td>3,331</td>
</tr>
<tr>
<td>Change in inventories</td>
<td>13</td>
<td>3,331</td>
</tr>
<tr>
<td>We've drawn of accounts payable and other current liabilities</td>
<td>41</td>
<td>192</td>
</tr>
<tr>
<td>Share of after-tax results of associates and joint-ventures</td>
<td>60</td>
<td>121</td>
</tr>
<tr>
<td>Net foreign exchange loss</td>
<td>6 (1,545)</td>
<td>(1,414)</td>
</tr>
<tr>
<td>Finance costs, net</td>
<td>1,446</td>
<td>4,704</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>60,946</td>
<td>158,511</td>
</tr>
</tbody>
</table>

CASH FLOWS FROM INVESTING ACTIVITIES

<table>
<thead>
<tr>
<th>Description</th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from sale of property, plant and equipment</td>
<td>(15,044)</td>
<td>27,683</td>
</tr>
<tr>
<td>Proceeds from sale of the State treasury bonds</td>
<td>10 (12,269)</td>
<td>148</td>
</tr>
<tr>
<td>Dividends received</td>
<td>30 (3,851)</td>
<td>-</td>
</tr>
<tr>
<td>Interest received</td>
<td>12</td>
<td>1,443</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>(22,830)</td>
<td>(23,567)</td>
</tr>
</tbody>
</table>

CASH FLOWS FROM FINANCING ACTIVITIES

<table>
<thead>
<tr>
<th>Description</th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from borrowings</td>
<td>12 (6,136)</td>
<td>43,865</td>
</tr>
<tr>
<td>Repayment of borrowings</td>
<td>12 (10,826)</td>
<td>(36,844)</td>
</tr>
<tr>
<td>Interest paid</td>
<td>12 (6,150)</td>
<td>(5,419)</td>
</tr>
<tr>
<td>Profit share and dividends paid</td>
<td>11,13 (39,625)</td>
<td>(20,754)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>(50,505)</td>
<td>(17,152)</td>
</tr>
</tbody>
</table>

Net cash used in financing activities

<table>
<thead>
<tr>
<th>Description</th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net (decrease)/increase in cash and cash equivalents</td>
<td>(53,885)</td>
<td>67,873</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>77,993</td>
<td>12,759</td>
</tr>
</tbody>
</table>

CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR

<table>
<thead>
<tr>
<th>Description</th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effect of exchange rates change on cash and cash equivalents</td>
<td>13,938</td>
<td>(3,039)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>37,106</td>
<td>77,593</td>
</tr>
</tbody>
</table>
1. THE ORGANISATION AND ITS OPERATIONS

Joint Stock Company "National Joint Stock Company "Naftogaz" (hereinafter referred to as the "Company") was founded in 1998 in accordance with the Resolution of the Cabinet of Ministers of Ukraine #747 dated 25 May 1998. According to the Resolution of the Cabinet of Ministers of Ukraine dated 6 March 2019 the Company was changed from Public to Private Joint Stock Company. Naftogaz is owned by the State of Ukraine. The Cabinet of Ministers of Ukraine executes the State corporate rights and the shareholders’ meetings and appoints the Supervisory Board that controls and regulates its business activities. Naftogaz and its subsidiaries (hereinafter collectively referred to as the "Group") is a vertically integrated oil and gas group of companies allowing optimisations across our portfolio. The Group is engaged in exploring for natural gas and oil, the development of new natural gas supplies, the transportation and storage of oil and gas and the sale of natural gas and liquefied petroleum gas to its customers. The Company holds equity stakes in entities that form the national facilities mainly in Ukraine. The principal subsidiaries and joint operations are:

Name/Type of activity

<table>
<thead>
<tr>
<th>% Interest held as at 31 December</th>
<th>Subsidiary/ Joint operations</th>
<th>Country of registration</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Production of gas, oil and refinery products</th>
</tr>
</thead>
</table>

- Ucraynozasovisnytsya, SCC
- Ukraina, PSC
- Petromaks Company, Joint operations with the Arab Republic of Egypt and Egyptian General Petroleum Corporation (EGPC)*
- Zakodromnynogy, SE

<table>
<thead>
<tr>
<th>Oil and gas transportation and storage</th>
</tr>
</thead>
</table>

- Ukraintrans, SCC
- Ukrainatransformator, SCC
- Ukrainmegatrans, SCC

<table>
<thead>
<tr>
<th>Wholesale and retail distribution of oil, gas and refinery products</th>
</tr>
</thead>
</table>

- Gas Ukraina, SE
- Gas supply company Naftogaz of Ukraine, LLC
- Gas supply company Naftogaz Trading, LLC
- Naftogaz Trading Europe AG
- Kirovogradtrans, OJSC
- Ukrgasvez, SE

2. OPERATING ENVIRONMENT

Since 2016, the Ukrainian economy has demonstrated signs of stabilization after years of political and economic tension. In 2020, the Ukrainian economy has contracted by around 4.4% real GDP because of COVID-19 outbreak and respective national lockdown initiatives (2019: real GDP growth of around 3.2%), but sustained the modest annual inflation of 5.0% (2019: 4.3%) with slight devaluation of national currency by around 4.9% to USD and 6.4% to EUR compared to previous years average.

To further facilitate business activities in Ukraine, the National Bank of Ukraine ("NBU") in 2019 has lifted the surrender requirement for foreign currency proceeds, cancelled all limits on repatriation of dividends and gradually decreased the discount rate for the first time during the recent two years, from 18.0% in November 2019 to 11.0% in January 2020, and further decreased down to 6.3% starting from March 2021.

An economic uncertainty in Ukraine in 2020 is still high due to a significant amount of public debt scheduled for repayment in 2021, which requires mobilizing substantial domestic and external financing in an increasingly challenging financing environment for emerging markets. Further economic growth depends, to a large extent, upon success of the Ukrainian government in realization of planned structural reforms and effective cooperation with the International Monetary Fund ("IMF"). In June 2020, the IMF approved an 18-month Stand-By Arrangement of equivalent USD 5 billion, aiming to provide balance of payments and budget support to help the authorities address the effects of the COVID-19 pandemic challenges. The approval of the agreement includes the immediate disbursement of the equivalent of about USD 2.1 billion.

The current rating of Ukraine’s Long-Term Foreign- and Local-Currency Issuer Default Ratings was assigned as ‘B’ by Fitch’s credit rating of Ukraine as a sovereign entity in April 2020.

The natural gas market of Ukraine is based on the principles of free and fair competition. The State does not interfere to the extent necessary to regulate market conditions or to ensure supply availability, taking into account the strategic interests, the general public interest, and the reputation of the natural gas market system. Ukraine. The principal subsidiaries and joint operations are:

3. RISKS AND CHALLENGES

In late 2019, news first emerged from China about the COVID-19 (Coronavirus). In early 2020 the virus spread globally and has caused significant economic, social, and health impacts worldwide. The virus has reached more than 200 countries and has continued to be a rapidly evolving economic and public health situation. The pandemic has resulted in widespread adverse impacts on the global economy, and there is considerable uncertainty regarding the extent to which COVID-19 will continue to spread and the extent and duration of governmental and other measures implemented to try to slow the spread of the virus, such as quarantines, shelter-in-place orders and other restrictions on business and personal travel. States and local authorities have also implemented multi-step policies with the goal of re-opening. However, certain jurisdictions began to reopen only to return to restrictions in the face of increases in new COVID-19 cases. The Group has taken certain precautionary measures that intend to help minimize the risks to its employees, the business and the communities in which it operates.

The Group assesses that the situation might potentially result in a significant decrease in the favourable price conditions in respect of raising financing on global markets. The Group assessed the impact of COVID-19 on its assets impairment, its revenue generating activities and its ability to generate sufficient cash flow to settle its liabilities when they are due to and maintain its operations in the foreseeable future. As of the date of the issuance of these consolidated financial statements, the Group’s operations have not been significantly impacted. Management continues to monitor the impact of COVID-19 on a regular basis, particularly with respect to potential consequences for financial condition and results of operations, cash flows, impairment of assets and on credit worthiness of customers.

The ultimate impact of COVID-19 will depend on future developments, including, among others, the ultimate geographic spread and severity of the virus, the consequences of governmental and other measures designed to prevent the spread of the virus, the development of effective treatments, the duration of the outbreak, actions taken by governments, customers, suppliers and other third parties, workforce availability, and the timing and extent to which normal economic and operating conditions resume. Management continues to make efforts to identify, manage and mitigate the economic disruption impacts of the COVID-19 pandemic to the Group; however, there are factors beyond its knowledge or control, including the duration and severity of this outbreak, any such similar outbreak, as well as further governmental and regulatory actions taken.

The natural gas market of Ukraine is based on the principles of free and fair competition. The State does not interfere to the extent necessary to regulate market conditions or to ensure supply availability, taking into account the strategic interests, the general public interest, and the reputation of the natural gas market system. Ukraine. The principal subsidiaries and joint operations are:
the Company filed third claim against the Cabinet of Ministers of Ukraine to admit the failure of the latter to identify sources of financing and provide compensation for performing public service obligations for the Company as a gas company with public service obligations, and it was also denied in favour of the Company in all court instances.

In October 2018 the Company initiated a claim in the Commercial Court of Kyiv City to request compensation for damages incurred when the company performed its public service obligation during the fourth quarter of 2015. The claim amounted to UAH 6.6 billion. In February 2019, the Commercial Court of Kyiv City rejected the claim. The Company appealed to this decision, and at the date of these consolidated financial statements the case is postponed until the resolution is received in another court hearing.

Moreover, in 2019 the Company has submitted two claims to the Commercial Court of Kyiv City to request compensation for damages incurred when the company performed its public service obligation during 2016-2018 in amount of approximately UAH 20 billion. In November 2020 the Commercial Court of Kyiv City has rejected one of the Company’s claims. Currently the Company appeals to this decision. There is no court decision in respect of another claim made by the Commercial Court of Kyiv City.

By the end of 2020 there were a number of actions that resulted in receiving the PSO compensation by the Company. In November 2020, the Parliament of Ukraine adopted amendments to the state budget for 2020, which, together with the relevant CMU resolutions, allowed the Company to receive such compensation. Later, in December 2020, the Ministry of Energy of Ukraine paid the Company compensation for imported gas supplied for the needs of the PSO customers during 2015-2019. The compensation received amounted to UAH 32.2 billion.

Out of the amount received together with own means of the Company, UAH 12.6 billion were paid to PJSC “Ukrnafta” for natural gas debt repayment, and UAH 23.5 billion were paid to PJSC “Ukrnafta” as an advance for gas of future production to be supplied in the next years, and UAH 6.4 billion of income tax were prepaid to the State Budget. PJSC “Ukrnafta”, in turn, settled its overdue tax liabilities to the state budget, including fines and penalties and prepaid UAH 3.2 billion of income tax to the State Budget. As a result, the Group received compensation of UAH 32.2 billion from the State Budget and repaid UAH 42.5 billion back to the State Budget.

Assets located at temporarily occupied territories

In early 2014, Ukraine suffered from the military aggression of the Russian Federation which resulted in the occupation of the Autonomous Republic of Crimea (“Crimea”) and unlawful military take-over of certain areas in Luhansk and Donetsk regions by armed terrorist groups, as well as the collapse of law enforcement in such areas. Management of the Group continues to undertake all possible legal and diplomatic means to be reimbursed for losses and to recover control of the Group’s assets in Crimea (Note 21).

Going concern

For the year ended 31 December 2020, the Group incurred net losses in the amount of UAH 19,022 million (year ended 31 December 2019: net profit from continuing operations of UAH 2,581 million). At the same time, the Group’s current assets exceeded its current liabilities by UAH 98,508 million as at 31 December 2020 and its net cash generated by operating activities was UAH 19,450 million.

Management of the Group believes that it is appropriate to prepare these consolidated financial statements on a going concern basis as the Group and the Government of Ukraine have undertaken several initiatives aimed to improve the financial performance and liquidity of the Group. The Group introduced cost optimisation measures, changed the scope of investment projects and deferred certain projects to 2021.

Management believes that the combination of the above mentioned and other measures from the Government of Ukraine will enable the Group to continue as a going concern. These consolidated financial statements do not include any adjustments relating to recoverability and classification of the recorded assets’ amounts, or to the amounts and classification of liabilities that may be necessary if the Group is unable to continue as a going concern.

3. SEGMENT INFORMATION

The Executive Board is the Group’s chief operating decision maker. In 2018 the Group started the organisational transformation into an efficient integrated national oil and gas company. Under the new operating model operations of the Group are organised by Business Delivery Units, Business Enabling Units and Functions. Business Delivery Units undertake the Group’s principal activities to achieve its financial and operational goals. Business Enabling Units and Functions support Business Delivery Units in order to maximise the value of the Group.

In 2020, as part of organisational transformation of the Group, integrated projects were set up to Exploration and Production and Commercial segments to improve the efficiency of all operations related to gas production and supplies to end users. Comparative information for the year ended 31 December 2019 was restated to reflect this change.

The Executive Board makes decisions about allocating resources and assessing performance for the following business units:

- Exploration and Production: Exploration and Production includes natural gas and gas condensate production, performed by “Ukrigazvydobuvannya” JSC. The Group controls about 70% of all natural gas production in Ukraine. Production of gas condensate is performed in the area of natural gas exploration.
- Commercial: Commercial includes purchasing domestic gas, gas imports, sales and supplies to different groups of customers. The result of this segment includes compensation for performing public service obligations in the amount of UAH 32,205 million contributing to comparability of results because in 2020 and previous years the revenue impacted by the PSO execution was also included in the same segment result.
- Other: Other consists of four main groups of customers in respect of gas sales and supplies:
  - Gas production, imports and sales to the regional gas supply companies (“RSC”) for the needs of households;
  - Gas production, imports and supply to the municipal heat generating entities (“MHE”) for the needs of households;
  - Gas production, imports and supply to the other customers under PSO;
  - Gas imports and supply to the other customers outside PSO and byproducts sales.

Each group of customers has its own selling price setting procedure and its own economic characteristics, such as products delivered to the end customers, their credit risks etc. Selling price for gas sales to RSC, MHE, and another group of customers is determined in accordance with the relevant CMU resolutions and allows the Company to compensate the City of Kyiv for the costs of natural gas supplied for public service obligations in the amount of UAH 32.2 billion from the State Budget and repaid UAH 42.5 billion.

Gas transit through the territory of Ukraine until 2024. In turn, Naftogaz receives gas transmission services from “Gas Transmission System Operator of Ukraine” LLC (Note 10) and renders gas transmission service to “Gazprom” JSC (Notes 14 and 16).

Gas storage. Ukrainian gas transmission system includes 12 underground gas storage facilities located in mainland Ukraine. The total capacity of the underground gas storage system located in Ukraine is 31 billion cubic meters of gas.

“Ukrtransnafta” JSC is the biggest oil producing company in Ukraine. “Ukrtransnafta” JSC is composed of several production and maintenance units, which are currently in the process of corporate restructuring, including six oil and gas production units, one well drilling division and three gas processing plants.

“Ukrtransnafta” JSC also owns one of the largest filling stations network in Ukraine located in different regions of Ukraine.

Other: Other includes results of investment activities under the concession agreement for exploration and development with the Arab Republic of Egypt, capital investment activities of the Group, corporate administrative functions, new energy and other activities.

Adjusted EBITDA is a measure of cash generated from operations of the Group before financing and investing activities. Adjusted EBITDA is the earnings measure used by the Executive Board for the purposes of making decisions about allocating resources and assessing performance. The earnings measure adjusted operating profit has been retired, and is no longer used to allocate resources and to assess performance, as the Executive Board believes that adjusted EBITDA better reflects segment results.

Adjusted EBITDA represents net profit/(loss) for the year after excluding the following income statement items: income tax (expense)/benefit, finance costs, finance income, share of after-tax results of associates, impairment of property, plant and equipment, amortisation, depreciation and depletion of property, plant and equipment and amortisation of intangible assets. Adjusted EBITDA is a measure of operating segments performance and liquidity.

Management uses capital expenditures and segment operating cash flows before working capital changes as measures of both a segment operational efficiency and its short-term financial health. Capital expenditures are presented on a cash basis for these purposes. Reallocations to the closest IFRS measure are presented in this note.

The accounting policies of the reportable segments are the same as the Group’s accounting policies described in Note 25.
### Segment Information for the Year Ended 31 December 2020

#### Exploration and production

<table>
<thead>
<tr>
<th>Segment</th>
<th>Sales – external</th>
<th>Sales to other segments</th>
<th>Total revenue</th>
<th>Segment adjusted EBITDA</th>
<th>Segment assets</th>
<th>Capital expenditure</th>
<th>Segment operating cash flows before working capital charges</th>
<th>Material non-cash items included in segment results:</th>
<th>Material non-cash items excluded from segment results:</th>
<th>Net impairment losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exploration and production</td>
<td>18</td>
<td>55,857</td>
<td>55,875</td>
<td>3,285</td>
<td>105,508</td>
<td>11,023</td>
<td>29,384</td>
<td>(11)</td>
<td>(12,478)</td>
<td>(4,802)</td>
</tr>
<tr>
<td>Oil midstream and downstream</td>
<td>10,666</td>
<td>835</td>
<td>11,501</td>
<td>9,628</td>
<td>18,777</td>
<td>1,185</td>
<td>2,154</td>
<td>64</td>
<td>(1,341)</td>
<td>(4,062)</td>
</tr>
<tr>
<td>Commercial</td>
<td>74,750</td>
<td>726</td>
<td>75,476</td>
<td>1,722</td>
<td>59,091</td>
<td>1,113</td>
<td>12,450</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>55,875</strong></td>
<td><strong>11,501</strong></td>
<td><strong>57,376</strong></td>
<td><strong>15,943</strong></td>
<td><strong>216,919</strong></td>
<td><strong>15,044</strong></td>
<td><strong>48,424</strong></td>
<td><strong>(39,766)</strong></td>
<td><strong>(16,548)</strong></td>
<td><strong>(7,828)</strong></td>
</tr>
</tbody>
</table>

#### Oil Midstream and Downstream

<table>
<thead>
<tr>
<th>Segment</th>
<th>Sales – external</th>
<th>Sales to other segments</th>
<th>Total revenue</th>
<th>Segment adjusted EBITDA</th>
<th>Segment assets</th>
<th>Capital expenditure</th>
<th>Segment operating cash flows before working capital charges</th>
<th>Material non-cash items included in segment results:</th>
<th>Material non-cash items excluded from segment results:</th>
<th>Net impairment losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exploration and production</td>
<td>3</td>
<td>77,862</td>
<td>77,865</td>
<td>5129</td>
<td>120,911</td>
<td>11,931</td>
<td>5,362</td>
<td>(213)</td>
<td>(45)</td>
<td>(65)</td>
</tr>
<tr>
<td>Oil midstream and downstream</td>
<td>11,931</td>
<td>963</td>
<td>12,904</td>
<td>28,210</td>
<td>99,091</td>
<td>1,835</td>
<td>14,989</td>
<td>(19)</td>
<td>(658)</td>
<td>(658)</td>
</tr>
<tr>
<td>Commercial</td>
<td>75,476</td>
<td>109,046</td>
<td>109,444</td>
<td>5,362</td>
<td>3,265</td>
<td>1,113</td>
<td>12,450</td>
<td>(527)</td>
<td>(2,498)</td>
<td>(149)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>77,865</strong></td>
<td><strong>12,904</strong></td>
<td><strong>90,769</strong></td>
<td><strong>1,525</strong></td>
<td><strong>149,781</strong></td>
<td><strong>15,044</strong></td>
<td><strong>43,367</strong></td>
<td><strong>(31,173)</strong></td>
<td><strong>(16,548)</strong></td>
<td><strong>(7,828)</strong></td>
</tr>
</tbody>
</table>

#### Commercial

<table>
<thead>
<tr>
<th>Segment</th>
<th>Sales – external</th>
<th>Sales to other segments</th>
<th>Total revenue</th>
<th>Segment adjusted EBITDA</th>
<th>Segment assets</th>
<th>Capital expenditure</th>
<th>Segment operating cash flows before working capital charges</th>
<th>Material non-cash items included in segment results:</th>
<th>Material non-cash items excluded from segment results:</th>
<th>Net impairment losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exploration and production</td>
<td>74,750</td>
<td>726</td>
<td>75,476</td>
<td>1,722</td>
<td>59,091</td>
<td>1,113</td>
<td>12,450</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Oil midstream and downstream</td>
<td>75,476</td>
<td>109,046</td>
<td>184,522</td>
<td>5,362</td>
<td>3,265</td>
<td>1,113</td>
<td>12,450</td>
<td>(527)</td>
<td>(2,498)</td>
<td>(149)</td>
</tr>
<tr>
<td>Commercial</td>
<td>74,750</td>
<td>726</td>
<td>75,476</td>
<td>1,722</td>
<td>59,091</td>
<td>1,113</td>
<td>12,450</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>74,750</strong></td>
<td><strong>726</strong></td>
<td><strong>82,081</strong></td>
<td><strong>1,722</strong></td>
<td><strong>59,091</strong></td>
<td><strong>1,113</strong></td>
<td><strong>12,450</strong></td>
<td><strong>(16,548)</strong></td>
<td><strong>(7,828)</strong></td>
<td><strong>(7,828)</strong></td>
</tr>
</tbody>
</table>

#### Gas Storage

<table>
<thead>
<tr>
<th>Segment</th>
<th>Sales – external</th>
<th>Sales to other segments</th>
<th>Total revenue</th>
<th>Segment adjusted EBITDA</th>
<th>Segment assets</th>
<th>Capital expenditure</th>
<th>Segment operating cash flows before working capital charges</th>
<th>Material non-cash items included in segment results:</th>
<th>Material non-cash items excluded from segment results:</th>
<th>Net impairment losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exploration and production</td>
<td>74,750</td>
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<td>75,476</td>
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<td>59,091</td>
<td>1,113</td>
<td>12,450</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
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<td>Oil midstream and downstream</td>
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<td>109,046</td>
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<td>5,362</td>
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<td>1,113</td>
<td>12,450</td>
<td>(527)</td>
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<td>(149)</td>
</tr>
<tr>
<td>Commercial</td>
<td>74,750</td>
<td>726</td>
<td>75,476</td>
<td>1,722</td>
<td>59,091</td>
<td>1,113</td>
<td>12,450</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>74,750</strong></td>
<td><strong>726</strong></td>
<td><strong>82,081</strong></td>
<td><strong>1,722</strong></td>
<td><strong>59,091</strong></td>
<td><strong>1,113</strong></td>
<td><strong>12,450</strong></td>
<td><strong>(16,548)</strong></td>
<td><strong>(7,828)</strong></td>
<td><strong>(7,828)</strong></td>
</tr>
</tbody>
</table>

#### Gas Transit Organisation Services

<table>
<thead>
<tr>
<th>Segment</th>
<th>Sales – external</th>
<th>Sales to other segments</th>
<th>Total revenue</th>
<th>Segment adjusted EBITDA</th>
<th>Segment assets</th>
<th>Capital expenditure</th>
<th>Segment operating cash flows before working capital charges</th>
<th>Material non-cash items included in segment results:</th>
<th>Material non-cash items excluded from segment results:</th>
<th>Net impairment losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exploration and production</td>
<td>74,750</td>
<td>726</td>
<td>75,476</td>
<td>1,722</td>
<td>59,091</td>
<td>1,113</td>
<td>12,450</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Oil midstream and downstream</td>
<td>75,476</td>
<td>109,046</td>
<td>184,522</td>
<td>5,362</td>
<td>3,265</td>
<td>1,113</td>
<td>12,450</td>
<td>(527)</td>
<td>(2,498)</td>
<td>(149)</td>
</tr>
<tr>
<td>Commercial</td>
<td>74,750</td>
<td>726</td>
<td>75,476</td>
<td>1,722</td>
<td>59,091</td>
<td>1,113</td>
<td>12,450</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>74,750</strong></td>
<td><strong>726</strong></td>
<td><strong>82,081</strong></td>
<td><strong>1,722</strong></td>
<td><strong>59,091</strong></td>
<td><strong>1,113</strong></td>
<td><strong>12,450</strong></td>
<td><strong>(16,548)</strong></td>
<td><strong>(7,828)</strong></td>
<td><strong>(7,828)</strong></td>
</tr>
</tbody>
</table>
Reconciliations
The following tables include reconciliations of segment information to the aggregate numbers of the consolidated financial statements, taking into account items which are not directly attributable to a segment.

4. BALANCES AND TRANSACTIONS WITH RELATED PARTIES

Parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Transactions with related parties were as follows:

<table>
<thead>
<tr>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade accounts receivable</td>
<td>32 %</td>
</tr>
<tr>
<td>Advances received and other current liabilities</td>
<td>38 %</td>
</tr>
<tr>
<td>Cash and bank balances</td>
<td>98 %</td>
</tr>
<tr>
<td>Provisions</td>
<td>16 %</td>
</tr>
<tr>
<td>Bank borrowings</td>
<td>29 %</td>
</tr>
<tr>
<td>Prepayments made and other current assets</td>
<td>96 %</td>
</tr>
</tbody>
</table>

Transactions with related parties for the period were as follows:

<table>
<thead>
<tr>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>26 %</td>
</tr>
<tr>
<td>Interest income on bank balances</td>
<td>99 %</td>
</tr>
<tr>
<td>Interest expense</td>
<td>37 %</td>
</tr>
</tbody>
</table>

Information on transactions with the State is further disclosed in Note 2 (Compensation for performing public service obligations). As at 31 December 2020, trade accounts receivable and advances received and other current liabilities amounted to UAH 22,562 million (2019: UAH 14,868 million).

As described in the Note 1, the Group is ultimately controlled by the Government of Ukraine, and therefore, all state-controlled entities and institutions are considered as related parties under common control.

Financial statements, taking into account items which are not directly attributable to a segment.
### 5. PROPERTY, PLANT AND EQUIPMENT

 Movements in the carrying amount of property, plant and equipment were as follows:

<table>
<thead>
<tr>
<th>In millions of Ukrainian hryvnias</th>
<th>Exploration, evaluation and drilling assets</th>
<th>Gas and oil upstream</th>
<th>Gas transmission system</th>
<th>Underground gas storages</th>
<th>Cushion gas</th>
<th>Oil transmission system</th>
<th>Gas and oil refining</th>
<th>Filling stations</th>
<th>Gas distribution assets</th>
<th>LNG transportation</th>
<th>Other fixed assets</th>
<th>Construction in progress</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net book value at 31 December 2018</td>
<td>6,241</td>
<td>95,021</td>
<td>85,913</td>
<td>12,573</td>
<td>186,497</td>
<td>8,658</td>
<td>2,697</td>
<td>4,306</td>
<td>152</td>
<td>147</td>
<td>3,639</td>
<td>30,526</td>
<td>434,370</td>
</tr>
<tr>
<td>Cost or valuation</td>
<td>5,014</td>
<td>106,649</td>
<td>188,162</td>
<td>13,829</td>
<td>186,497</td>
<td>14,571</td>
<td>3,025</td>
<td>4,659</td>
<td>187</td>
<td>189</td>
<td>8,262</td>
<td>32,806</td>
<td>563,850</td>
</tr>
<tr>
<td>Accumulated depreciation and impairment</td>
<td>(773)</td>
<td>(11,628)</td>
<td>(102,249)</td>
<td>(1,256)</td>
<td>-</td>
<td>(5,913)</td>
<td>(328)</td>
<td>(353)</td>
<td>(35)</td>
<td>(42)</td>
<td>(4,623)</td>
<td>(2,280)</td>
<td>(129,480)</td>
</tr>
<tr>
<td>Additions and transfers</td>
<td>7,646</td>
<td>14,378</td>
<td>761</td>
<td>(1,078)</td>
<td>-</td>
<td>653</td>
<td>1,193</td>
<td>107</td>
<td>12</td>
<td>9</td>
<td>2,720</td>
<td>6,178</td>
<td>32,579</td>
</tr>
<tr>
<td>Revaluation</td>
<td>(1,530)</td>
<td>6,571</td>
<td>38,062</td>
<td>(3,736)</td>
<td>(117,257)</td>
<td>(553)</td>
<td>861</td>
<td>(270)</td>
<td>-</td>
<td>-</td>
<td>366</td>
<td>(1,788)</td>
<td>(77,486)</td>
</tr>
<tr>
<td>Disposals</td>
<td>(14)</td>
<td>(134)</td>
<td>69</td>
<td>-</td>
<td>-</td>
<td>4</td>
<td>(1)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(189)</td>
<td>(978)</td>
<td>(2,251)</td>
</tr>
<tr>
<td>Depreciation charge</td>
<td>(1,212)</td>
<td>(12,293)</td>
<td>(19,747)</td>
<td>(900)</td>
<td>-</td>
<td>(577)</td>
<td>(349)</td>
<td>(230)</td>
<td>(9)</td>
<td>(17)</td>
<td>(623)</td>
<td>-</td>
<td>(36,047)</td>
</tr>
<tr>
<td>Impairment</td>
<td>(65)</td>
<td>(57)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(8)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>28</td>
<td>(3,136)</td>
<td>(2,238)</td>
</tr>
<tr>
<td>Reclassification to assets of discontinued operations classified as held for sale and distribution</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(113)</td>
<td>(2,250)</td>
</tr>
</tbody>
</table>

| Net book value at 31 December 2019 | 9,066 | 103,486 | 86,760 | 69,240 | 8,181 | 4,390 | 3,932 | 155 | 505 | 5,462 | 29,340 | 240,506 |
| Cost or valuation | 9,411 | 106,843 | - | 6,768 | 69,240 | 8,330 | 4,514 | 3,974 | 198 | 518 | 9,978 | 34,666 | 254,457 |
| Accumulated depreciation and impairment | (345) | (3,357) | - | (16) | - | (149) | (124) | (62) | (63) | (13) | (4,516) | (5,326) | (33,951) |
| Additions and transfers | 1,921 | 15,256 | - | - | - | 116 | 227 | 133 | 19 | 9 | 26 | (429) | (221) | 17,256 |
| Disposals | (36) | (128) | - | - | - | - | (3) | (2) | - | - | - | (3) | (1,384) | (1,588) |
| Depreciation charge | (1,412) | (14,751) | - | (436) | - | (568) | (446) | (239) | (65) | (33) | (477) | - | (18,425) |
| Impairment/reclassification | (81) | (11,909) | - | - | - | (590) | (446) | (788) | 533 | - | (1,421) | (3,759) | (26,615) |

| Net book value at 31 December 2020 | 9,458 | 91,954 | 6,655 | 59,501 | 8,319 | 4,122 | 3,021 | 634 | 498 | 3,100 | 23,976 | 211,134 |
| Cost or valuation | 11,190 | 122,885 | - | 7,284 | 59,501 | 8,389 | 4,715 | 4,104 | 697 | 542 | 8,765 | 32,862 | 260,952 |
| Accumulated depreciation and impairment | (1,732) | (30,931) | - | (733) | - | (70) | (613) | (1,083) | (63) | (44) | (5,663) | (8,886) | (49,818) |
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

6. INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

The Group’s investments in associates and joint ventures were as follows:

<table>
<thead>
<tr>
<th>In millions of Ukrainian hryvnias</th>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investments in associates</td>
<td>767</td>
<td>820</td>
</tr>
<tr>
<td>Investments in joint ventures</td>
<td>5</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td>772</td>
<td>835</td>
</tr>
</tbody>
</table>

Details of each of the Group’s associates and joint ventures as at 31 December 2020 are as follows:

| Name of associate/joint ventures | Place of incorporation and principal place of business | Proportion of ownership interest | Additional interest acquired | Share of loss | Share of other comprehensive income/(loss) | Dividends received from the associate | Net foreign exchange income | Provision for impairment | Carrying amount |
|----------------------------------|------------------------------------------------------|---------------------------------|------------------------------|---------------|------------------------------------------|--------------------------------------|---------------------------|------------------------|----------------|----------------|
| "Gaztransit" PJSC               | Ukraine                                                | 40.2 %                          | -                            | (53)          | -                                        | -                                    | -                         | -                      | 767            |                |
| "Ukrtatnafta" PJSC               | Oil refinery                                           | 43.05 %                         | -                            | -             | -                                        | -                                    | -                         | -                      | 5              |                |
| Other                            | Ukraine                                                | miscellaneous                   | -                            | (12)          | -                                        | 2                                    | -                         | -                      |                |                |
|                                  |                                                       |                                 |                              |               |                                          |                                      |                           |                        |                |                |
|                                  |                                                       |                                 |                              | -             | (65)                                     | -                                    | 2                         | -                      | 772            |                |

Details of each of the Group’s associates and joint ventures as at 31 December 2020 are as follows:

<table>
<thead>
<tr>
<th>Name of associate/joint ventures</th>
<th>Place of incorporation and principal place of business</th>
<th>Proportion of ownership interest</th>
<th>Additional interest acquired</th>
<th>Share of loss</th>
<th>Share of other comprehensive income/(loss)</th>
<th>Dividends received from the associate</th>
<th>Net foreign exchange loss</th>
<th>Provision for impairment</th>
<th>Carrying amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Gaztransit&quot; PJSC</td>
<td>Ukraine</td>
<td>40.2 %</td>
<td>-</td>
<td>(74)</td>
<td>137</td>
<td>(4)</td>
<td>-</td>
<td>-</td>
<td>820</td>
</tr>
<tr>
<td>&quot;Ukrtatnafta&quot; PJSC</td>
<td>Oil refinery</td>
<td>43.05 %</td>
<td>-</td>
<td>(42)</td>
<td>4</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(295)</td>
</tr>
<tr>
<td>Other</td>
<td>Ukraine</td>
<td>miscellaneous</td>
<td>-</td>
<td>(5)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-</td>
<td>(121)</td>
<td>130</td>
<td>(4)</td>
<td></td>
<td>(139)</td>
</tr>
</tbody>
</table>

All of the above associates are accounted for using the equity method in these consolidated financial statements.
The Group’s other non-current assets were as follows:

<table>
<thead>
<tr>
<th></th>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable on product sharing agreement</td>
<td>5,250</td>
<td>4,504</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>3,333</td>
<td>3,101</td>
</tr>
<tr>
<td>Restructured accounts receivable of gas consumers</td>
<td>2,146</td>
<td>2,979</td>
</tr>
<tr>
<td>Other</td>
<td>2,371</td>
<td>2,730</td>
</tr>
<tr>
<td>Less: provision for impairment</td>
<td>(7,062)</td>
<td>(4,809)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>6,039</strong></td>
<td><strong>8,505</strong></td>
</tr>
</tbody>
</table>

Accounts receivable on product sharing agreement. The Company entered into a concession agreement for hydrocarbon exploration and development with the Arab Republic of Egypt and Egyptian General Petroleum Corporation ("EGPC") on 13 December 2006. Under the terms of the concession agreement, the Company has the right to recover all exploration and development costs incurred in connection with the concession agreement (Note 22). The amount presented in the table above represents such costs claimed by the Group for recovery, and which are expected to be refunded after one year since the reporting date.

In 2010 the Group recognised an impairment loss in respect of accounts receivable on product sharing agreement and other non-current assets in net impairment losses amounting to UAH 2,158 million (2019: UAH 916 million).

Intangible assets. As at 31 December 2020 and 2019, included in intangible assets are licenses for exploration and extraction of oil and natural gas amounting to UAH 1,802 million and UAH 1,953 million, respectively.

Restructured accounts receivable of gas consumers. In May 2011, the Law of Ukraine "On certain matters on indebtedness for natural gas and electricity consumed" #1310-V was approved. According to this Law, accounts receivable due from entities supplying natural gas under the regulated tariff that were originated in 2010, were restructured for the period from 1 to 20 years and are stated at amortised cost using effective interest rate which at the restructuring dates varied from 8% to 16% per annum.

As at 31 December 2020 outstanding amount per gas debt restructuring agreements according to this Law included in other non-current assets was UAH 579 million (31 December 2019: UAH 831 million). Fulfilment of gas debt restructuring agreements is guaranteed by municipal executive government bodies representing particular territorial community as set by the separate guarantee agreements.

Other. As at 31 December 2020 and 2019, included in other non-current assets are research and development expenditures amounting to UAH 1,800 million and UAH 895 million, respectively, that were incurred within the concession agreement for oil exploration and development with the EGPC on 13 December 2006, but not yet claimed for recovery (Note 25).

In November 2016 the Law of Ukraine "On measures to settle the debts for the natural gas consumed by municipal heat generating entities and distribution and water supplying companies" #13730 was adopted. According to this Law, accounts receivable due from municipal heat generating entities and distribution were restructured for 5 years and are stated at amortised cost using effective interest rate which at the restructuring dates varied from 8% to 13% per annum.

Movements in provision for impairment of non-current accounts receivable were as follows:

<table>
<thead>
<tr>
<th>In millions of Ukrainian hryvnias</th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Accounts receivable on product sharing agreement</strong></td>
<td>3,268</td>
<td>2,202</td>
</tr>
<tr>
<td>Reversal of provision for impairment</td>
<td>2,158</td>
<td>1,299</td>
</tr>
<tr>
<td>Other movements</td>
<td>(20)</td>
<td>(22)</td>
</tr>
<tr>
<td><strong>Balance at 31 December</strong></td>
<td>5,406</td>
<td>3,268</td>
</tr>
</tbody>
</table>

As at 31 December 2020 and 2019, included in provision for impairment for other non-current assets was provision for impairment of intangible assets in amount of UAH 1,655 million and UAH 1,541 million, respectively.

Other movements in provision for impairment of non-current accounts receivable relate to reclassification of provision between current and non-current accounts receivable.

The Group’s inventories were as follows:

<table>
<thead>
<tr>
<th>In millions of Ukrainian hryvnias</th>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Natural gas</td>
<td>30,521</td>
<td>45,847</td>
</tr>
<tr>
<td>Crude oil</td>
<td>3,639</td>
<td>5,492</td>
</tr>
<tr>
<td>Petroleum products</td>
<td>2,243</td>
<td>3,516</td>
</tr>
<tr>
<td>Spare parts</td>
<td>1,964</td>
<td>2,308</td>
</tr>
<tr>
<td>Raw materials</td>
<td>1,169</td>
<td>1,349</td>
</tr>
<tr>
<td>Other</td>
<td>1,155</td>
<td>1,198</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>40,691</strong></td>
<td><strong>57,705</strong></td>
</tr>
</tbody>
</table>

Management estimates the necessity of write-down of inventories to their net realisable value taking into consideration indicators of economical and physical obsolescence. In 2020 write-down adjustment amounted to UAH 96 million was included in selling, general and administrative expenses (Note 17) (2019: UAH 679 million included in purchases (Note 16) and UAH 539 million included in selling, general and administrative expenses, and UAH 1,239 million change by discontinued operations).

As at 31 December 2020 and 2019, inventories with carrying amount of UAH 17,323 million and UAH 30,984 million, respectively, were pledged as collateral for borrowings (Note 12).

The Group’s trade accounts receivable were as follows:

<table>
<thead>
<tr>
<th>In millions of Ukrainian hryvnias</th>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable for natural gas</td>
<td>86,202</td>
<td>73,436</td>
</tr>
<tr>
<td>Accounts receivable for gas balancing services</td>
<td>43,622</td>
<td>44,059</td>
</tr>
<tr>
<td>Accounts receivable for petroleum products</td>
<td>12,909</td>
<td>10,987</td>
</tr>
<tr>
<td>Accounts receivable for crude oil</td>
<td>6,251</td>
<td>7,740</td>
</tr>
<tr>
<td>Accounts receivable for gas transportation services</td>
<td>3,347</td>
<td>8,504</td>
</tr>
<tr>
<td>Other accounts receivable</td>
<td>127,446</td>
<td>(88,278)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>28,129</strong></td>
<td><strong>59,056</strong></td>
</tr>
</tbody>
</table>

Movements in provision for impairment of trade accounts receivable were as follows:

<table>
<thead>
<tr>
<th>In millions of Ukrainian hryvnias</th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance at 1 January</strong></td>
<td>98,278</td>
<td>69,775</td>
</tr>
<tr>
<td>Provision for impairment recognised during the period</td>
<td>55,320</td>
<td>22,965</td>
</tr>
<tr>
<td>Reversal of provision for impairment</td>
<td>(16,338)</td>
<td>(17,274)</td>
</tr>
<tr>
<td>Amounts written off as uncollectible</td>
<td>(106)</td>
<td>(1,735)</td>
</tr>
<tr>
<td>Provision recognised from discontinued operations</td>
<td>492</td>
<td>(592)</td>
</tr>
<tr>
<td><strong>Balance at 31 December</strong></td>
<td>127,446</td>
<td>88,278</td>
</tr>
</tbody>
</table>

As at 31 December 2020 management have assessed the expected credit losses for trade receivables for gas of regional gas distribution entities at 100% due to the fact that there were no settlement of outstanding balances after abolishment of PSD for these entities (Note 26). This resulted in higher expense on provision for impairment recognised in 2020 comparing to 2019.

Other movements in provision for impairment of trade accounts receivable relate to reclassification of provision between current and non-current accounts receivable and to difference in proportion of assets and profits consolidation related to joint ventures of one of the Group’s subsidiaries, recognised in equity movement.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

Analysis of credit quality of trade accounts receivable is as follows:

### 10. PREPAYMENTS MADE AND OTHER CURRENT ASSETS

The Group's prepayments made and other current assets were as follows:

<table>
<thead>
<tr>
<th>Trade accounts receivable - days past due</th>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>In millions of Ukrainian hryvnias</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Not past due</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 - 90</td>
<td></td>
<td></td>
</tr>
<tr>
<td>91 - 180</td>
<td></td>
<td></td>
</tr>
<tr>
<td>181 - 270</td>
<td></td>
<td></td>
</tr>
<tr>
<td>271 - 365</td>
<td></td>
<td></td>
</tr>
<tr>
<td>&gt; 365</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross carrying amount</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provision for impairment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expected credit loss rate, %</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total non-financial assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepayments for pipelines construction</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepayments to suppliers for materials,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>works and services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepayment for gas transit services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VAT recoverable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepayments for pipelines construction</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepayments to suppliers for natural gas</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other non-financial assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total non-financial assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>22,641</td>
<td>9,487</td>
</tr>
</tbody>
</table>

### 11. SHARE CAPITAL

As at 31 December 2020 and 2019, nominal amount of registered, issued and fully paid share capital of the Company was UAH 100,150 million, comprising 190,150,481 ordinary shares, with a par value of UAH 1,000 per share. The Company has additional paid capital of UAH 8,168 million to the budget as dividends. In total, during 2019, the Company paid UAH 12,252 thousand, or 90% of its net profit for 2018.

### 12. BORROWINGS

The Group's borrowings were as follows:

<table>
<thead>
<tr>
<th>In millions of Ukrainian hryvnias</th>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>56,547</td>
<td>47,144</td>
</tr>
<tr>
<td>Current</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank borrowings</td>
<td>8,427</td>
<td>12,178</td>
</tr>
<tr>
<td>Interest accrued</td>
<td>1,368</td>
<td>1,336</td>
</tr>
<tr>
<td>Total current portion</td>
<td>9,795</td>
<td>13,514</td>
</tr>
<tr>
<td>Total</td>
<td>66,342</td>
<td>60,662</td>
</tr>
</tbody>
</table>

Not published by 30 June 2019, and following the requirements of the Ukrainian legislation, the Company paid 30% of its net profit amounting to UAH 4,084 million to the State Budget. After the Cabinet of Ministers of Ukraine published its Resolution #461-r, the Company has additionally paid UAH 8,168 million to the budget as dividends. In total, during 2019, the Company paid UAH 12,252 thousand, or 90% of its net profit for 2018.

As at 31 December 2019, the Company accrued a provision of UAH 15,197 million in respect of the portion of net profit attributable to the State Budget of Ukraine in current provisions (Note 13). Then, following the Resolution of the Cabinet of Ministers of Ukraine #1339-r dated 26 December 2019, the Company has paid UAH 6,500 million out of this amount in December 2019 as dividends per results of 2019. In total, with the Resolution of the Cabinet of Ministers of Ukraine #328-r of 24 April 2020, the basic standard of dividend distribution was set at 95% net profit of the Company for 2019. In June 2020 the Company has additionally paid UAH 39,625 million to the State Budget. In total, the Company paid UAH 48,125 million or 95% of the Company's net profit for 2019 to the State Budget.

As at 31 December 2020, the Group accrued a provision of UAH 3,842 million in respect of the portion of net profit of "Ukrnafta" PSC attributable to the State Budget of Ukraine (UAH 1,921 million) and other equity holders (UAH 1,921 million) in current provisions (Note 13).
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

The Company issued Eurobonds via Kondor Finance plc (a public company with limited liability incorporated in England and Wales) using the loan participation notes structure. The Group does not control or exercise significant influence over Kondor Finance plc.

The coupon rate and carrying amount of Eurobonds issued were as follows:

<table>
<thead>
<tr>
<th>Issue of July 2019 (Tranche A)</th>
<th>Issue of July 2019 (Tranche B)</th>
<th>Issue of November 2019</th>
<th>Carrying amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>7.125</td>
<td>7.375</td>
<td>7.625</td>
<td>44,383</td>
</tr>
<tr>
<td>July 2024</td>
<td>July 2022</td>
<td>November 2020</td>
<td>35,518</td>
</tr>
<tr>
<td>600</td>
<td>335</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td>Euro</td>
<td>US dollars</td>
<td>US dollars</td>
<td></td>
</tr>
<tr>
<td>20,802</td>
<td>9,457</td>
<td>14,124</td>
<td>31 December 2020</td>
</tr>
<tr>
<td>15,400</td>
<td>7,910</td>
<td>11,828</td>
<td>31 December 2019</td>
</tr>
</tbody>
</table>

In 2020 the Company has concluded several additional agreements with state-owned banks in respect of changes to the borrowings repayment schedules prolonging their maturities up to 2022. The Company has analysed impact of these changes and concluded that they do not represent significant modification to the financial liabilities.

The average effective interest rates and currency denomination of borrowings were as follows:

<table>
<thead>
<tr>
<th>31 December 2019</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance</td>
<td>% per annum</td>
</tr>
<tr>
<td>US dollars</td>
<td>32,640</td>
</tr>
<tr>
<td>Euro</td>
<td>24,405</td>
</tr>
<tr>
<td>UAH</td>
<td>9,297</td>
</tr>
<tr>
<td>Total</td>
<td>66,342</td>
</tr>
<tr>
<td>31 December 2019</td>
<td></td>
</tr>
<tr>
<td>Balance</td>
<td>60,662</td>
</tr>
</tbody>
</table>

PLEDGES

The Group’s borrowings were secured by the following pledges:

<table>
<thead>
<tr>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>In millions of Ukrainian hryvnias</td>
<td></td>
</tr>
<tr>
<td>Inventories (Note 8)</td>
<td>17,323</td>
</tr>
<tr>
<td>Proceeds from future sales</td>
<td>14,412</td>
</tr>
<tr>
<td>Property, plant and equipment (Note 5)</td>
<td>3,134</td>
</tr>
<tr>
<td>Total</td>
<td>34,869</td>
</tr>
</tbody>
</table>

Guarantees.

As at 31 December 2020, the Group’s borrowings in the amount of UAH 2,783 million were guaranteed by the State (31 December 2019: UAH 2,694 million).
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020**

### 13. PROVISIONS

Movements in provisions for the years ended 31 December 2020 and 2019 were as follows:

<table>
<thead>
<tr>
<th>In millions of Ukrainian hryvnas</th>
<th>Provisions for litigations</th>
<th>Employee benefit obligations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance at 31 December 2018</strong></td>
<td>15,254</td>
<td>6,501</td>
</tr>
<tr>
<td>Provision for dividends payable to the State Budget (Note 11)</td>
<td>(1,367)</td>
<td>2,165</td>
</tr>
<tr>
<td>Unwinding of discount</td>
<td>-</td>
<td>635</td>
</tr>
<tr>
<td>Used or paid during the year</td>
<td>(1,283)</td>
<td>(2,374)</td>
</tr>
<tr>
<td>Revaluation</td>
<td>-</td>
<td>1,133</td>
</tr>
<tr>
<td>Reclassification to liabilities of discontinued operations as held for sale and distribution</td>
<td>-</td>
<td>(195)</td>
</tr>
<tr>
<td><strong>Balance at 31 December 2019</strong></td>
<td>12,604</td>
<td>7,866</td>
</tr>
<tr>
<td>Non-current</td>
<td>12,604</td>
<td>5,101</td>
</tr>
<tr>
<td>Current</td>
<td>2,760</td>
<td>2,760</td>
</tr>
<tr>
<td><strong>Provision for dividends payable to the State Budget and other equity holders (Note 11)</strong></td>
<td>3,419</td>
<td>2,747</td>
</tr>
<tr>
<td>Charged/(reversed) during the year</td>
<td>(13,433)</td>
<td>(3,438)</td>
</tr>
<tr>
<td>Unwinding of discount</td>
<td>(1)</td>
<td>(791)</td>
</tr>
<tr>
<td>Used or paid during the year</td>
<td>362</td>
<td>(16,820)</td>
</tr>
<tr>
<td>Revaluation</td>
<td>(453)</td>
<td>(6,697)</td>
</tr>
<tr>
<td><strong>Balance at 31 December 2020</strong></td>
<td>2,590</td>
<td>8,049</td>
</tr>
<tr>
<td>Non-current</td>
<td>-</td>
<td>4,671</td>
</tr>
<tr>
<td>Current</td>
<td>2,590</td>
<td>3,378</td>
</tr>
</tbody>
</table>

The principal actuarial assumptions used were as follows:

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nominal discount rate, %</td>
<td>9.6-10.0</td>
<td>9.2-9.5</td>
</tr>
<tr>
<td>Long-term inflation, %</td>
<td>4.8</td>
<td>5.0-6.5</td>
</tr>
<tr>
<td>Nominal salary increase rate, %</td>
<td>4.8-5.0</td>
<td>5.0-6.0</td>
</tr>
<tr>
<td>Staff turnover rate, %</td>
<td>1.5-2.0</td>
<td>1.2-1.6</td>
</tr>
</tbody>
</table>

The sensitivity analysis presented above may not be representative of the actual change in the non-current employee benefit obligations as it is unlikely that the change in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

Furthermore, in presenting the above sensitivity analysis, the present value of the employee benefit obligations has been calculated using the projected unit credit method at the end of the reporting period, which is the same as that applied in calculating the obligation recognised in the consolidated statement of financial position.

There were no changes in the methods and assumptions used in preparing the sensitivity analysis prior years.

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**Provisions for Litigations**

The Group is involved into a number of litigations both as a plaintiff and as a defendant. Provision for litigations represents management assessment of the probable outflow of the Group’s resources arising from an adverse outcome of the court and arbitration procedures.

In 2013, "Ukrtransgaz" JSC filed a claim with the Commercial Court of the Kyiv City against Naftogaz stating that seeking the transfer of 4.75 bcm of natural gas to the gas transmission system was acquired without sufficient legal grounds. The claim was granted in 2013 and further upheld by the court of appeal and court of cassation. Then, in 2015, Naftogaz filed an application for revision of the Commercial Court of the city of Kyiv judgement based on newly discovered circumstances, and the latter suspended the proceedings in this case pending finalisation of the proceedings in a related case that also remain suspended.

However, as the judgement of the Commercial Court of the Kyiv City has entered into force in 2018 in respect of transfer of 1.09 bcm out of 4.75 bcm, Naftogaz created a provision in respect of this case amounting other operating expense in 2018. In May 2020, the Company has transferred 1.09 bcm of gas to the underground storages of "Ukrtransgaz" JSC, utilising the
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

15. PRODUCTION AND MANUFACTURING EXPENSES

In 2020, the Group changed its presentation of the consolidated statement of profit and loss for the year ended 31 December 2019. The comparative statement information has been restated to reflect the changes (Note 26).

<table>
<thead>
<tr>
<th>Description</th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subsoil royalty and other taxes other than on income</td>
<td>25,914</td>
<td>32,873</td>
</tr>
<tr>
<td>Staff costs and related social charges</td>
<td>7,596</td>
<td>6,427</td>
</tr>
<tr>
<td>Transportation of oil and natural gas</td>
<td>3,130</td>
<td>2,544</td>
</tr>
<tr>
<td>Crude oil processing services</td>
<td>3,022</td>
<td>2,265</td>
</tr>
<tr>
<td>Repair and maintenance costs</td>
<td>2,605</td>
<td>2,360</td>
</tr>
<tr>
<td>Materials</td>
<td>2,607</td>
<td>4,282</td>
</tr>
<tr>
<td>Utilities</td>
<td>1,541</td>
<td>1,130</td>
</tr>
<tr>
<td>Other</td>
<td>2,297</td>
<td>1,991</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>48,212</strong></td>
<td><strong>53,870</strong></td>
</tr>
</tbody>
</table>

Subsoil royalty and rent tax are calculated with reference to the volume of crude oil, gas condensate or natural gas produced and, in the case of natural gas, amounting to UAH 10 million (2019: UAH 15 million).

16. PURCHASES

In 2020, the Group changed its presentation of the consolidated statement of profit and loss for the year ended 31 December 2019. The comparative statement information has been restated to reflect the changes (Note 26).

<table>
<thead>
<tr>
<th>Description</th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gas transit organisation services (Note 25)</td>
<td>44,858</td>
<td>-</td>
</tr>
<tr>
<td>Gas</td>
<td>16,706</td>
<td>35,772</td>
</tr>
<tr>
<td>Oil and petroleum products</td>
<td>2,813</td>
<td>4,986</td>
</tr>
<tr>
<td>Write-off of purchased inventories to net realisable value</td>
<td>-</td>
<td>679</td>
</tr>
<tr>
<td>Other</td>
<td>181</td>
<td>152</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>64,558</strong></td>
<td><strong>41,549</strong></td>
</tr>
</tbody>
</table>

17. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

In 2020, the Group changed its presentation of the consolidated statement of profit and loss for the year ended 31 December 2019. The comparative statement information has been restated to reflect the changes (Note 26).

<table>
<thead>
<tr>
<th>Description</th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff costs and related social charges</td>
<td>4,149</td>
<td>7,047</td>
</tr>
<tr>
<td>Non-refundable VAT</td>
<td>4,747</td>
<td>937</td>
</tr>
<tr>
<td>Professional fees</td>
<td>948</td>
<td>1,220</td>
</tr>
<tr>
<td>Charity and social infrastructure</td>
<td>788</td>
<td>137</td>
</tr>
<tr>
<td>Change in provisions for litigations and other provisions</td>
<td>624</td>
<td>1,783</td>
</tr>
<tr>
<td>Transportation costs</td>
<td>509</td>
<td>356</td>
</tr>
<tr>
<td>Loss on disposal of property, plant and equipment and intangible assets</td>
<td>442</td>
<td>861</td>
</tr>
<tr>
<td>Court fees and charges</td>
<td>400</td>
<td>1,399</td>
</tr>
<tr>
<td>Write-down of inventories to net realisable value</td>
<td>96</td>
<td>540</td>
</tr>
<tr>
<td>Other</td>
<td>4,637</td>
<td>1,345</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>21,340</strong></td>
<td><strong>16,015</strong></td>
</tr>
</tbody>
</table>

Additionally to the audit fees related to the compulsory audit as included to the professional fees, are other audit fees for 2020 amounting to UAH 10 million (2019: UAH 15 million).
18. FINANCE COSTS

In millions of Ukrainian hryvnias

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest expense on borrowings</td>
<td>5,614</td>
<td>5,464</td>
</tr>
<tr>
<td>Unwinding of discount</td>
<td>1,011</td>
<td>909</td>
</tr>
<tr>
<td>Other</td>
<td>113</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>6,738</td>
<td>6,377</td>
</tr>
</tbody>
</table>

19. INCOME TAX

The components of income tax expense from continuing operations for the years ended 31 December were as follows:

Income tax expenses

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current tax expense</td>
<td>4,789</td>
<td>6,132</td>
</tr>
<tr>
<td>Deferred tax expense/(benefit)</td>
<td>171</td>
<td>(3,822)</td>
</tr>
<tr>
<td>Income tax expenses</td>
<td>4,960</td>
<td>2,310</td>
</tr>
</tbody>
</table>

The Group is subject to taxation in Ukraine. In 2020 and 2019, Ukrainian corporate income tax was levied on taxable income less allowable expenses at the rate of 18%.

Reconciliation between the expected and the actual taxation charge is provided below:

Income tax expenses

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Loss)/Profit before income tax</td>
<td>(14,042)</td>
<td>4,891</td>
</tr>
<tr>
<td>Income tax (benefit)/expense at statutory rate of 18%</td>
<td>(2,528)</td>
<td>880</td>
</tr>
</tbody>
</table>

The Parent and its subsidiaries are separate tax payers and, therefore, their deferred tax assets and liabilities are presented on an individual basis. The deferred tax liabilities and assets reflected in the consolidated statement of financial position after appropriate set-off are as follows:

Net deferred tax liabilities as at 31 December 2020 related to the following:

<table>
<thead>
<tr>
<th></th>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant and equipment</td>
<td>(18,912)</td>
<td>3,141</td>
</tr>
<tr>
<td>Trade accounts receivable</td>
<td>916</td>
<td>1,336</td>
</tr>
<tr>
<td>Advances received and other current liabilities</td>
<td>58</td>
<td>6</td>
</tr>
<tr>
<td>Provisions</td>
<td>7,403</td>
<td>(5,280)</td>
</tr>
<tr>
<td>Inventories</td>
<td>1,452</td>
<td>(737)</td>
</tr>
<tr>
<td>Prepayments made and other current assets</td>
<td>659</td>
<td>(495)</td>
</tr>
<tr>
<td>Other non-current assets</td>
<td>18</td>
<td>64</td>
</tr>
<tr>
<td>Unearned tax losses</td>
<td>7</td>
<td>1,811</td>
</tr>
<tr>
<td>Net deferred tax liability</td>
<td>(8,419)</td>
<td>(171)</td>
</tr>
</tbody>
</table>

Net deferred tax liabilities as at 31 December 2019 related to the following:

<table>
<thead>
<tr>
<th></th>
<th>31 December 2019</th>
<th>31 December 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant and equipment</td>
<td>(55,520)</td>
<td>3,725</td>
</tr>
<tr>
<td>Trade accounts receivable</td>
<td>386</td>
<td>530</td>
</tr>
<tr>
<td>Advances received and other current liabilities</td>
<td>85</td>
<td>(17)</td>
</tr>
<tr>
<td>Provisions</td>
<td>7,403</td>
<td>(338)</td>
</tr>
<tr>
<td>Inventories</td>
<td>1,860</td>
<td>(297)</td>
</tr>
<tr>
<td>Prepayments made and other current assets</td>
<td>564</td>
<td>45</td>
</tr>
<tr>
<td>Other non-current assets</td>
<td>18</td>
<td>646</td>
</tr>
<tr>
<td>Unearned tax losses</td>
<td>7</td>
<td>1,811</td>
</tr>
<tr>
<td>Net deferred tax liability</td>
<td>(45,425)</td>
<td>3,822</td>
</tr>
</tbody>
</table>

As at 31 December 2020 and 2019, unrecognised deductible temporary differences and unused tax losses are as follows:

<table>
<thead>
<tr>
<th></th>
<th>31 December 2019</th>
<th>31 December 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provisions</td>
<td>7,403</td>
<td>7,423</td>
</tr>
<tr>
<td>Trade accounts receivable</td>
<td>386</td>
<td>530</td>
</tr>
<tr>
<td>Inventories</td>
<td>1,860</td>
<td>1,452</td>
</tr>
<tr>
<td>Prepayments made and other current assets</td>
<td>564</td>
<td>45</td>
</tr>
<tr>
<td>Other non-current assets</td>
<td>18</td>
<td>64</td>
</tr>
<tr>
<td>Unearned tax losses</td>
<td>7</td>
<td>1,811</td>
</tr>
<tr>
<td>Total</td>
<td>109,576</td>
<td>130,856</td>
</tr>
</tbody>
</table>
20. DISCONTINUED OPERATIONS AND CONSIDERATION RECEIVABLE UNDER THE SPA

On 1 January 2020 current obligations of Naftogaz and “Ukrtransgaz” JSC to operate state-owned gas transmission infrastructure were terminated. 100% of the participatory rights of “Gas Transmission System Operator of Ukraine” LLC were transferred to “Makhistrahylospromyvodvyhnytsia” JSC under a sale and purchase agreement (SPA). As specified in the SPA, the Group is entitled to receive the initial fixed payment in amount of UAH 3,871 million and regular variable payments for 15 years based on dynamic price calculated in accordance with the formula agreed by the parties. At the time of sale of “Gas Transmission System Operator of Ukraine” LLC, the fair value of the variable consideration receivable was determined at UAH 81,306 million. In addition, on 1 January 2020, “Ukrtransgaz” JSC sold its own gas reserve for the system operation to “Gas Transmission System Operator of Ukraine” LLC in amount of UAH 4,530 million. The Group received the initial fixed payment in amount of UAH 3,851 million in late 2020.

Details of the sale of the subsidiary:

- In millions of Ukrainian hryvnia

<table>
<thead>
<tr>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total consideration receivable</td>
<td>89,707</td>
</tr>
<tr>
<td>Net assets associated with disposal group</td>
<td>-</td>
</tr>
<tr>
<td>Loss on disposal of subsidiary</td>
<td>(8,100)</td>
</tr>
</tbody>
</table>

The major group of assets and liabilities comprising the operations classified as held for sale and distribution are as follows:

- In millions of Ukrainian hryvnia

<table>
<thead>
<tr>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant and equipment</td>
<td>108,421</td>
</tr>
<tr>
<td>Other non-current assets</td>
<td>5,393</td>
</tr>
<tr>
<td>Inventories</td>
<td>492</td>
</tr>
<tr>
<td>Trade accounts receivable</td>
<td>-</td>
</tr>
<tr>
<td>Prepayments made and other current assets</td>
<td>-</td>
</tr>
<tr>
<td>Prepaid corporate income tax</td>
<td>-</td>
</tr>
<tr>
<td>Cash and bank balances</td>
<td>-</td>
</tr>
<tr>
<td>Provisions</td>
<td>-</td>
</tr>
<tr>
<td>Deferred tax liabilities</td>
<td>-</td>
</tr>
<tr>
<td>Trade account payable</td>
<td>-</td>
</tr>
<tr>
<td>Advances received and other current liabilities</td>
<td>-</td>
</tr>
<tr>
<td>Net assets directly associated with disposal group</td>
<td>-</td>
</tr>
</tbody>
</table>

The results of the discontinued operations, which have been included in the profit for the year, were as follows:

- In millions of Ukrainian hryvnia

<table>
<thead>
<tr>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>70,071</td>
</tr>
<tr>
<td>Arbitration</td>
<td>-</td>
</tr>
<tr>
<td>Interest and other income</td>
<td>-</td>
</tr>
<tr>
<td>Expenses</td>
<td>77,360</td>
</tr>
<tr>
<td>Profit before income tax</td>
<td>-</td>
</tr>
<tr>
<td>Attributable income tax expense</td>
<td>60,713</td>
</tr>
<tr>
<td>Profit for the year from discontinued operations (attributable to owners of the Company)</td>
<td>60,713</td>
</tr>
</tbody>
</table>

21. CONTINGENCIES, COMMITMENTS AND OPERATING RISKS

Tax legislation.

On 16 January 2020, the Ukraine parliament adopted a tax reform bill containing significant proposed changes to the tax legislation, including recommendations under the OECD base erosion and profit shifting (BEPS) project, as well as significant changes to tax administration procedures. Measures in the reform include the introduction of the three-tiered transfer pricing reporting requirements, a new fixed ratio rule that limits the amount of interest expense, general anti-abuse rules (GAAR), new controlled foreign company (CFC) rules, and a mutual agreement procedure (MAP). Additionally the rule that depreciation of property, plant and equipment is not accrued for the period of their non-use in connection to their modernization, reconstruction, completion was excluded.

The new Law No. 466-IIX was signed by the President of Ukraine on 21 May 2020 and partially came into force from 23 May 2020.

Management believes that the Group has been in compliance with all requirements of the effective tax legislation and changes of tax legislation does not have significant effect on operation of the Group and its consolidated financial statements.

The Ukraine tax environment is characterised by complexity in tax administering, arbitrary interpretation by tax authorities of tax laws and regulations that, inter alia, can increase fiscal pressure on taxpayers. Inconsistent application, interpretation, and enforcement of tax laws can lead to litigation which, as a consequence, may result in the imposition of additional taxes, penalties, and interest, and these amounts could be material.

Management believes that the Group has been in compliance with all requirements of the effective tax legislation. In the ordinary course of business the Group is engaged in transactions that may be interpreted differently by the Group and tax authorities. Where the risk of outflow of financial resources associated with this is deemed to be probable and the amount is measured with sufficient reliability, the Group provides for those liabilities. Where management of the Group estimates the risk of financial resources outflow as possible, the Group makes a disclosure of these contingent liabilities.

As at 31 December 2020, management estimated possible tax exposures in total amount of UAH 15,472 million (31 December 2019: UAH 15,733 million).

Management believes that it is not likely that any significant settlement will arise from the above cases and, therefore, the Group’s consolidated financial statements do not include any amount of provision in this respect.

The Group conducts transactions with its subsidiaries. It is possible with evolution of the interpretation of tax law in Ukraine and changes in the approach of tax authorities under the Tax Code, that such transactions could be challenged in the future. The impact of any such challenge cannot be estimated, however, management believes that it should not be significant.

The Group exports refinery products and transportation services, performs intercompany transactions and is involved in transactions with related parties, which may potentially be in the scope of the new Ukrainian transfer pricing (“TP”) regulations. The Group’s companies have submitted the controlled transaction reports for the year ended 31 December 2019 within the required deadline. The report on controlled transactions for the year ended 31 December 2020 shall be prepared by the Group’s companies by 1 October 2021.

Management believes that the Group is in compliance with TP requirements. As the practice of implementation of the new transfer pricing rules has not yet developed and wording of some clauses of the rules may be subject to various interpretations, the impact of challenge of the Group’s companies transfer pricing positions by the tax authorities cannot be reliably estimated.

Claim against the Russian Federation regarding assets in Crimea.

In October 2016, Naftogaz and its subsidiaries initiated arbitration proceedings against the Russian Federation seeking compensation for the losses caused by unlawful expropriation of Group’s assets in Crimea by the Russian Federation. These arbitration proceedings were initiated under the Agreement between the Cabinet of Ministers of Ukraine and the Government of the Russian Federation on mutual encouragement and protection of investments.

On 15 September 2017, Naftogaz and its subsidiaries have submitted the Statement of Claim to the Tribunal under the auspices of the Permanent Court of Arbitration in The Hague.

On 22 February 2019, the Tribunal issued Partial Final Award on jurisdiction and responsibility in favour of the Group. The Tribunal acknowledged its jurisdiction over the claims and ruled that the Russian Federation is responsible for violation of the particular articles of the Agreement between the Cabinet of Ministers of Ukraine and the Government of the Russian Federation on mutual encouragement and protection of investments, including article on prohibition of expropriation.

On 27 June 2019, Naftogaz submitted its Memorial on Quantum to the Tribunal under the auspices of the Permanent Court of Arbitration in The Hague regarding the amount of compensation for the assets that were unlawfully expropriated by the Russian Federation in Crimea. Russia submitted its Counter-Memorial on Quantum in December 2019.

On 14 February 2020, Group submitted its Reply Memorial on Quantum, responding to Russia’s Counter-Memorial on Quantum, responding to Russia’s Counter-Memorial on Quantum, responding to Russia’s Counter-Memorial on Quantum.
Quantum. In its Reply Memorial, Naftogaz further substantiates its claim for compensation for its assets that the Russian Federation unlawfully expropriated in Crimea in March 2014 – valued at approximately USD 5 billion, plus interest (for a total of more than USD 9 billion). A hearing on quantum is scheduled for June 2021 in The Hague. The final award on the quantum is expected by the middle of 2022.

Legal proceedings.

In the normal course of business, the Group is subject to claims. Where the group of outflows of financial resources associated with such claims is assumed as probable, a respective liability is recognised as a component of provision for litigations (Note 13). Where management estimates the risk of outflow of financial resources associated with such claims as possible, or amount of outflow cannot be measured reliably, no provision is recognised, and respective amount is disclosed in the consolidated financial statements.

Management believes that it has provided for all material losses in these consolidated financial statements.

Joint operations with Misen Enterprises AB, and “Karpatygaz” LLC.

As a part of determining the validity of the joint arrangement, in July 2016, the Group initiated legal proceedings in the Stockholm Arbitration on termination or recognition as invalid of this agreement. In July 2018, the Arbitration Institute of the Stockholm Chamber of Commerce has issued a Partial Final Award regarding termination of the joint arrangement agreement. The Arbitral Tribunal found that the joint arrangement agreement had been violated by both Misen Enterprises AB and “Karpatygaz” LLC and is therefore terminated due to the change in circumstances and impossibility to continue the joint operation arrangement. In June 2020, the Stockholm Chamber of Commerce has rendered a Second Partial Final Award revising the parties’ shares in the joint property.

In November 2020, the Stockholm Chamber of Commerce has rendered a Final Award by consent. The Final Award records the procedure of electing the Chairman of the Board from amongst its members; proposals for the Supervisory Board candidates are formed by the parties independently in accordance with the Ukrnafta’s charter; the chairman of the executive board and its members are elected by the Supervisory Board. Other provisions of the shareholders agreement remain unchanged.

Possible transfer of the Company’s equity interest in the subsidiaries to the State.

In 1998, upon creation of the Company, the Government of Ukraine contributed shares of joint stock companies to the share capital of the Company including “Long-Distance Pipelines “Druzhba” JSC and “Prydniprovsky Long-Distance Pipeline” JSC (that were subsequently contributed to “Ukrtransnafta” JSC share capital, “Karpatygas” SE, “Chornomornagaz”, SE, “Ukrnafta” OISC, and fifty four regional gas distribution entities. The Government of Ukraine may decide to transfer shares (stakes) or ownership or control over all or part of the Company’s equity interest in those joint stock companies and/or companies, and those actions could have a material adverse effect on the Company’s operations.

State property not subject to privatisation.

In 1998, the Company entered into an agreement “On use of the State owned property not subject to privatisation” (“Agreement”) with the State Property Fund of Ukraine, and received oil and gas transportation and storage systems into the operational control. The Agreement was signed for one year, and its term is prolonged automatically for one year, unless terminated by notice from either party, and is binding on the legal successor of each party. Historically, the agreement has been prolonged automatically, as neither party initiated its termination. As the State property not subject to privatisation forms an essential part of the Group’s business, the future operations and financial performance of the Group depends on the prolongation of the Agreement. The Group’s management believes that the Group will continue to operate with this property in the foreseeable future.

Pursuant to the Agreement, the Company is required, inter alia, to handle oil and gas transmission and distribution pipelines owned by the State of Ukraine, keep the state property in adequate operational condition, and transfer 50% share of profits received from using those assets to the State. The amount of such transfer could be reduced by the amount of capital investments in those assets. The Agreement does not provide a mechanism of such calculations, and historically, there were no payments from the Company to the State in respect of using such assets. The Company believes that the mechanism for calculating the state share in profits from using the assets being determined by the State, the capital investments performed by the Company would be greater, and no payment in favour of the State would occur. Accordingly, no liability for such payment was recognised in these consolidated financial statements.

As described in Note 20, on 1 January 2020 current

22. FINANCIAL RISK MANAGEMENT

The Group is exposed to a variety of financial risks: market risk (including currency risk and interest rate risk), concentration risk (Note 3), credit risk and liquidity risk. According to its risk management policy the Group identifies, assesses and develops actions to minimise the potential adverse effects on the Group’s financial performance for those risks.
Currency risk.
The Group operates within Ukraine and its exposure to foreign currency risk is determined mainly by purchases of natural gas from foreign suppliers, which are denominated in USD and EUR. The Group also receives borrowings in foreign currencies. The Group does not hedge its foreign currency positions.

The Group's exposure to foreign currency risk is as follows, based on carrying amounts of respective currency assets and liabilities:

<table>
<thead>
<tr>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD</td>
<td>EUR</td>
</tr>
<tr>
<td>Restricted cash</td>
<td>584</td>
</tr>
<tr>
<td>Cash and bank balances</td>
<td>21,770</td>
</tr>
<tr>
<td>Trade accounts receivable</td>
<td>867</td>
</tr>
<tr>
<td>Prepayments made and other current assets</td>
<td>8,501</td>
</tr>
<tr>
<td>Other non-current assets</td>
<td>-</td>
</tr>
<tr>
<td>Borrowings</td>
<td>(32,640)</td>
</tr>
<tr>
<td>Trade accounts payable</td>
<td>(640)</td>
</tr>
<tr>
<td>Advances received and other current liabilities</td>
<td>(370)</td>
</tr>
<tr>
<td>Other long-term liabilities</td>
<td>(3,235)</td>
</tr>
</tbody>
</table>

Net (short)/long currency position | (5,063) | (16,658) | 28 | 37,644 | (13,041) | 37 |

The following table presents sensitivities of profit or loss and equity to reasonably possible changes in exchange rates applied at the reporting date, with all other variables held constant.

<table>
<thead>
<tr>
<th>31 December 2020</th>
<th>Impact on profit or loss before tax</th>
<th>Impact on equity net income</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD strengthening by 10%</td>
<td>(506)</td>
<td>1,767</td>
</tr>
<tr>
<td>USD weakening by 10%</td>
<td>506</td>
<td>415</td>
</tr>
<tr>
<td>EUR strengthening by 10%</td>
<td>(1,666)</td>
<td>(1,266)</td>
</tr>
<tr>
<td>EUR weakening by 10%</td>
<td>1,666</td>
<td>1,266</td>
</tr>
</tbody>
</table>

Interest rate risk.
The Group normally has no significant interest bearing assets, and its income and operating cash flows are substantially independent of changes in market interest rates. The Group’s interest rate risk exposure arises from borrowings at variable interest rates. Borrowings at fixed rate expose the Group to the fair value interest rate risk.

The Group attracts borrowings at both fixed and floating interest rates. As at 31 December 2020 around 1% of the Group’s entities.

The Group’s interest rate risk exposure arises from borrowings at variable interest rates. Borrowings at fixed rate expose the Group to the fair value interest rate risk.

The Group’s interest rate risk exposure arises from borrowings at variable interest rates. Borrowings at fixed rate expose the Group to the fair value interest rate risk.

The Group determines other price risk as risk of possible future losses as a result of price volatility during purchase and sale transactions. Both volatility in gas prices at the European gas hubs that impacts gas purchase prices, and gas sale and supply to customers at prices set by the NCREU within PSO imposed on the Company (Note 2) expose the Group to the price risk. To manage this risk and offset its negative impact on the Group’s financial position, the Group, amongst other measures, is actively taking part in gas market reform in Ukraine and introduces the principle of free pricing for all groups of customers. In gas supply for groups of customers at prices established independently by Naftogaz on a monthly basis price risk is not considered to be significant.

Credit risk.
The Group is exposed to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises as a result of the Group’s sales of products on credit terms and other transactions with counterparties giving rise to financial assets.

The Group’s policy is that the customers that wish to pay on credit terms are subject to the solvency check. Significant outstanding balances are also reviewed on an ongoing basis. At the same time, the Group must follow the state regulations within public service obligations in respect of gas sales to certain gas market participants irrespective of whether they are delinquent or not. The Group makes a provision for impairment that represents its estimate of expected losses in respect of trade accounts receivable. The main component of this provision relates to specific individually significant exposures. In particular as at 31 December 2020 the credit risk associated with the Consideration receivable under SPA (Note 20), was considered. The impact of such considerations is incorporated in discounted cash flows model used for determining fair value of the asset (Note 23). The risk of changes to the agreement by the Government have been considered as the counterparty to the agreement addressed the Government asking to start negotiations for possible revision of dynamic component of the agreement. As no actions have been taken by any party concerned as of the date of these consolidated financial statements no changes were made with regard to this matter to the fair value model.

The maximum exposure to credit risk as at 31 December 2020 is UAH 162,392 million (31 December 2019: UAH 143,107 million).

The following table presents credit quality analysis for cash and cash equivalents and cash collateral for participation in the State procurement procedures as at 31 December based on Fitch ratings:

<table>
<thead>
<tr>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and bank balances</td>
<td>Restricted cash</td>
</tr>
<tr>
<td>A rating</td>
<td>58</td>
</tr>
<tr>
<td>B rating</td>
<td>3,601</td>
</tr>
<tr>
<td>No rating</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>37,106</td>
</tr>
</tbody>
</table>

The Group does not hold any collateral as a security for its credit risks related to financial assets, except for guarantees received in respect of restructured accounts receivable of gas consumers within the scope of the Law of Ukraine “On measures to settle the debts for the natural gas consumed by municipal heat generating entities and distribution and water supplying companies” #1730 (Note 2). Amount of such collateral as at 31 December 2020 amounted to UAH 986 million (31 December 2019: UAH 1,318 million).

Liquidity risk. Prudent liquidity management implies maintaining sufficient cash and the availability of funding to meet existing obligations as they fall due. The Group’s objective is to maintain a balance between the continuity of funding and the use of flexible credit terms provided by suppliers and banks. Prepayments are commonly used to manage both liquidity and credit risks. The Group analyses ageing of its assets and maturity of its liabilities and plans liquidity depending on their expected repayment. The Group has capital construction programs which are funded both through existing business cash flows and borrowed funds. Borrowed funds are also used to finance the Group’s working capital needs.

The following table analyses the Group’s financial liabilities by relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table are undiscounted cash flows of principal and interest payments.
The maturity analysis of financial liabilities as at 31 December 2020 was as follows:

<table>
<thead>
<tr>
<th>In millions of Ukrainian hryvnias</th>
<th>Up to 6 months</th>
<th>6-12 months</th>
<th>1-2 years</th>
<th>2-5 years</th>
<th>Over 5 years</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrowings</td>
<td>7,147</td>
<td>6,478</td>
<td>17,653</td>
<td>37,282</td>
<td>15,295</td>
<td>83,855</td>
</tr>
<tr>
<td>Trade accounts payable</td>
<td>3,585</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3,585</td>
</tr>
<tr>
<td>Advances received and other</td>
<td>4,130</td>
<td>-</td>
<td>871</td>
<td>3,035</td>
<td>-</td>
<td>3,096</td>
</tr>
<tr>
<td>current liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other long-term liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>14,656</td>
<td>6,478</td>
<td>18,524</td>
<td>40,317</td>
<td>15,265</td>
<td>95,476</td>
</tr>
</tbody>
</table>

The maturity analysis of financial liabilities as at 31 December 2019 was as follows:

<table>
<thead>
<tr>
<th>In millions of Ukrainian hryvnias</th>
<th>Up to 6 months</th>
<th>6-12 months</th>
<th>1-2 years</th>
<th>2-5 years</th>
<th>Over 5 years</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrowings</td>
<td>9,501</td>
<td>8,265</td>
<td>7,015</td>
<td>42,608</td>
<td>13,808</td>
<td>81,197</td>
</tr>
<tr>
<td>Trade accounts payable</td>
<td>5,061</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>5,061</td>
</tr>
<tr>
<td>Advances received and other</td>
<td>3,194</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3,194</td>
</tr>
<tr>
<td>current liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other long-term liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>17,956</td>
<td>8,265</td>
<td>8,075</td>
<td>44,802</td>
<td>13,808</td>
<td>92,306</td>
</tr>
</tbody>
</table>

Gearing ratio.
Consistent with others in the industry, the Group monitors capital on the basis of gearing ratio. This ratio is calculated as net debt divided by total capital plus net debt under management. Net debt is calculated as total borrowings (current and non-current as shown in the consolidated statement of financial position) less cash and cash equivalents. Total capital under management equals total equity as shown in the consolidated statement of financial position. As at 31 December 2019, cash and cash equivalents for the gearing calculation were adjusted for cash received from Gazprom and interim dividends paid. There were no adjustments to the gearing ratio calculation as at 31 December 2020.

Gearing ratio at the end of the reporting period was as following:

<table>
<thead>
<tr>
<th>In millions of Ukrainian hryvnias</th>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total borrowings (Note 12)</td>
<td>66,342</td>
<td>60,562</td>
</tr>
<tr>
<td>Less: cash and cash equivalents</td>
<td>(37,106)</td>
<td>(37,593)</td>
</tr>
<tr>
<td>Adjusted for cash received from Gazprom and interim dividends paid</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total Net Debt</td>
<td>29,236</td>
<td>22,969</td>
</tr>
<tr>
<td>Total Equity</td>
<td>314,281</td>
<td>392,574</td>
</tr>
<tr>
<td>Gearing ratio, %</td>
<td>8.5</td>
<td>9.8</td>
</tr>
</tbody>
</table>

23. FAIR VALUE
International Financial Reporting Standards defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The estimated fair values have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. Management used all available market information in estimating the fair value. The estimates presented herein are not necessarily indicative of the amounts the Group could realise in a market exchange from the sale of its full holdings of a particular instrument or pay in the transfer of liabilities.

Fair value of property, plant and equipment
Property, plant and equipment are measured at fair value at the end of each reporting period. The following table provides information about how the fair values of these assets are determined (in particular, the valuation techniques and inputs used):

<table>
<thead>
<tr>
<th>Assets</th>
<th>Fair value hierarchy</th>
<th>Valuation techniques and key inputs</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>Property, plant and equipment</td>
<td>The Group engages professional independent appraisers to determine the fair value of its property, plant and equipment by using a replacement cost method for the majority of groups. The fair value is determined as the cost of construction of these items at current prices less the economic obsolescence and physical tear and wear to date. The main parameter used in this valuation technique are current prices on construction. For items for which there are market analogues (mainly buildings), the sales comparison method is used, the prices of market-based sales of comparable properties in the immediate proximity are adjusted with reference to differences in main parameters (such as floor space of the property). The main parameter used in this valuation technique is the price per square meter of a property. The fair value of cushion gas in case of no economic obsolescence (tested using the income approach) is equal to the replacement cost defined as market price of gas pumped in the underground gas storages adjusted for cost of transportation from the point of sale to the underground storages and costs of its pumping. If economic obsolescence is identified, the value of cushion gas adjusted for economic obsolescence will not be lower than its liquidation cost, determined based on the assumptions of the period of gas withdrawal, volume of gas that is possible to pull up, market price of gas in the relevant periods, the rate of return on the regulatory basis of assets for storage, average profitability of gas withdrawal and costs of its transportation to the point of sale.</td>
</tr>
<tr>
<td>2</td>
<td>Property, plant and equipment</td>
<td>For the items for which there are market analogues (mainly buildings), the sales comparison method is used, the prices of market-based sales of comparable properties in the immediate proximity are adjusted with reference to differences in main parameters (such as floor space of the property). The main parameter used in this valuation technique is the price per square meter of a property.</td>
</tr>
</tbody>
</table>

The following table summarises property, plant and equipment recognised at fair value after initial recognition using a fair value hierarchy:

<table>
<thead>
<tr>
<th>In millions of Ukrainian hryvnias</th>
<th>31 December 2020</th>
<th>31 December 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant and equipment</td>
<td>4,219</td>
<td>179,839</td>
</tr>
<tr>
<td></td>
<td>148,058</td>
<td>184,058</td>
</tr>
<tr>
<td>Total</td>
<td>4,219</td>
<td>179,839</td>
</tr>
<tr>
<td>Total</td>
<td>4,219</td>
<td>179,839</td>
</tr>
</tbody>
</table>

The Group has transferred cushion gas from Level 2 to Level 3 of the fair value hierarchy on 1 October 2019 due to a change in valuation methodology.
Details of the Group’s property, plant and equipment and information about the fair value hierarchy as at 31 December 2020 are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Group of assets</th>
<th>Valuation technique</th>
<th>Unobservable inputs</th>
<th>Range of unobservable inputs</th>
<th>Interrelationship between key unobservable inputs and fair value measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gas storages</td>
<td>Underground gas storage equipment</td>
<td>Depreciated replacement cost method using the income approach for economic obsolescence determination</td>
<td>Nominal WACC for USD-denominated cash flows</td>
<td>14.35%</td>
<td>The higher the weighted average cost of capital, the lower the fair value</td>
</tr>
<tr>
<td></td>
<td>Cushion gas</td>
<td>Estimated average period of cushion gas withdrawal</td>
<td>5 years starting from 2025</td>
<td>The longer the period, the lower the fair value</td>
<td></td>
</tr>
<tr>
<td>Gas extraction assets</td>
<td>Gas and oil upstream</td>
<td>Depreciated replacement cost method using the income approach for economic obsolescence determination</td>
<td>Natural gas selling price</td>
<td>Market price forecast is based on regression analysis of historical NBP and TTF hub gas prices. The results were applied to the consensus forecast of the NBP hub price and applied to the TTF hub price forecast. Forecast Hub + prices are calculated as follows: TTF gas hub forecast plus spread between TTF and VTP hub (Slovakia) gas prices plus entry fee to the GTS of Ukraine.</td>
<td>The higher the selling price, the higher the fair value</td>
</tr>
<tr>
<td></td>
<td>Long-term forecast of royalty rates (estimated for selling price)</td>
<td>Natural gas and crude oil deposits at depths up to 5000 m – 29%, over 5000 m – 14%</td>
<td>The higher the rate, the lower the fair value</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Oil and gas condensate deposits at depths up to 5000 m – 31%, over 5000 m – 16%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Nominal weighted average cost of capital for UAH denominated cash flows</td>
<td>15.96%-17.93%</td>
<td>The higher the weighted average cost of capital, the lower the fair value</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Proven developed reserves as assessed by the independent appraiser</td>
<td>1 – 47.681 mcm (remaining gas reserves depending on the field)</td>
<td>The higher the volume, the higher the fair value</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oil transmission system and storages</td>
<td>Oil transmission system</td>
<td>Depreciated replacement cost method using the income approach for economic obsolescence determination</td>
<td>Cumulative factor of physical and functional depreciations</td>
<td>0.28-0.80</td>
<td>The higher the factor, the lower the fair value</td>
</tr>
<tr>
<td></td>
<td>Transit volumes</td>
<td></td>
<td>12.0-13.4 million tons</td>
<td>The higher the volumes, the higher the fair value</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Applicable tariffs</td>
<td></td>
<td>8.6-11.6 euro per ton</td>
<td>The higher the tariff, the higher the fair value</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Nominal WACC for UAH-denominated cash flows</td>
<td></td>
<td>12.54%</td>
<td>The higher the weighted average cost of capital, the lower the fair value</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Nominal WACC for USD-denominated cash flows</td>
<td></td>
<td>13.24%</td>
<td>The higher the weighted average cost of capital, the lower the fair value</td>
<td></td>
</tr>
</tbody>
</table>

Details of the Group’s property, plant and equipment and information about the fair value hierarchy as at 31 December 2019 are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Group of assets</th>
<th>Valuation technique</th>
<th>Unobservable inputs</th>
<th>Range of unobservable inputs</th>
<th>Interrelationship between key unobservable inputs and fair value measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gas storages</td>
<td>Underground gas storage equipment</td>
<td>Depreciated replacement cost method using the income approach for economic obsolescence determination</td>
<td>The rate of return on the regulatory basis of assets for storage</td>
<td>14.52%</td>
<td>The higher the rate, the higher the fair value</td>
</tr>
<tr>
<td></td>
<td>Cushion gas</td>
<td>Nominal WACC for USD-denominated cash flows</td>
<td>12.57%</td>
<td>The higher the weighted average cost of capital, the lower the fair value</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Estimated average period of cushion gas withdrawal</td>
<td>5 years</td>
<td>The longer the period, the lower the fair value</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gas extraction assets</td>
<td>Gas and oil upstream</td>
<td>Depreciated replacement cost method using the income approach for economic obsolescence determination</td>
<td>Natural gas selling price</td>
<td>Market price forecast is based on regression analysis of historical NBP and TTF hub gas prices. The results were applied to the consensus forecast of the NBP hub price and applied to the TTF hub price forecast. Forecast Hub + prices are calculated as follows: TTF gas hub forecast plus spread between TTF and VTP hub (Slovakia) gas prices plus entry fee to the GTS of Ukraine.</td>
<td>The higher the selling price, the higher the fair value</td>
</tr>
<tr>
<td></td>
<td>Long-term forecast of royalty rates (estimated for selling price)</td>
<td>Natural gas and crude oil deposits at depths up to 5000 m – 29%, over 5000 m – 14%</td>
<td>The higher the rate, the lower the fair value</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Oil and gas condensate deposits at depths up to 5000 m – 31%, over 5000 m – 16%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Nominal weighted average cost of capital for UAH denominated cash flows</td>
<td>15.96%-17.93%</td>
<td>The higher the weighted average cost of capital, the lower the fair value</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Proven developed reserves as assessed by the independent appraiser</td>
<td>1 – 47.681 mcm (remaining gas reserves depending on the field)</td>
<td>The higher the volume, the higher the fair value</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oil transmission system and storages</td>
<td>Oil transmission system</td>
<td>Depreciated replacement cost method using the income approach for economic obsolescence determination</td>
<td>Cumulative factor of physical and functional depreciations</td>
<td>0.28-0.80</td>
<td>The higher the factor, the lower the fair value</td>
</tr>
<tr>
<td></td>
<td>Transit volumes</td>
<td></td>
<td>12.0-13.4 million tons</td>
<td>The higher the volumes, the higher the fair value</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Applicable tariffs</td>
<td></td>
<td>8.6-11.6 euro per ton</td>
<td>The higher the tariff, the higher the fair value</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Nominal WACC for UAH-denominated cash flows</td>
<td></td>
<td>12.54%</td>
<td>The higher the weighted average cost of capital, the lower the fair value</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Nominal WACC for USD-denominated cash flows</td>
<td></td>
<td>13.24%</td>
<td>The higher the weighted average cost of capital, the lower the fair value</td>
<td></td>
</tr>
</tbody>
</table>
The following table provides information about how the fair value of financial assets and financial liabilities was determined (in particular, the valuation techniques and inputs used):

<table>
<thead>
<tr>
<th>Financial liabilities</th>
<th>Fair value hierarchy</th>
<th>Valuation techniques and key inputs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eurobonds</td>
<td>1</td>
<td>Fair value of Eurobonds is measured at quoted prices in active markets using interest rates of 5.0%-6.6% p.a.</td>
</tr>
</tbody>
</table>

The fair value of State treasury bonds measured at fair value through profit or loss, related to level 1 of fair value hierarchy and measured at quoted prices in active markets.

The following table provides information about how the fair value of variable consideration is determined (in particular, the valuation techniques and inputs used):

<table>
<thead>
<tr>
<th>Consideration receivable</th>
<th>Fair value hierarchy</th>
<th>Valuation techniques and key inputs</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>The Group determines the fair value of the future expected cash flows. The inputs are based on management projections, analyst expectations, and industry forecasts. The estimates are based on a discount rate of 1.74%</td>
<td></td>
</tr>
</tbody>
</table>

Valuation technique: Unobservable inputs

Range of unobservable inputs

Interrelationship between key unobservable inputs and fair value measurement

Discounted cash flow model

Method when tranche revenues are received: 2020-2024 — the longer the period of income generation from bonds, the higher the fair value


The higher the volumes, the higher the fair value

Regulated asset base tariffs

For the first decade (2020-2024) fixed tariffs for transportation services were used for the period 2020-2024. From 2024 and onwards tariffs for transportation services were calculated based on the long-term stimulatory tariff regulation methodology parameters.

The lower the RBA, the lower the fair value

Variables used for USD-denominated cash flows

13.3% — The higher the weighted average cost of capital, the lower the fair value

There were no changes in valuation techniques during the period. There were no transfers between Level 2 and Level 3 during the period.

24. SUBSEQUENT EVENTS

Loans repayment. During January-March 2021 the Group repaid UAH 574 million of bank borrowings.

Acquisition of “Nadra Yuzivska LLC”. In January 2021, the Group acquired 100% of the corporate rights in the share capital of “Nadra Yuzivska LLC”, which has the right to explore and extract hydrocarbons in the Yuzivska site located in Donetsk and Kharkiv region and has special permits until 2063. The cost of investments amounted to UAH 452 million.

25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance. These consolidated financial statements have been prepared in accordance with IFRS.

Basis of preparation of consolidated financial statements. This consolidated financial statements have been prepared on the historical cost basis except for property, plant and equipment that are measured at revalued amounts at the end of each reporting period and certain financial instruments measured at fair value as explained in the accounting policies below.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique.

These policies have been consistently applied to all periods presented, unless otherwise stated.

Functional and presentation currency. The financial statements of each of the Group’s entities are measured using the currency of the primary economic environment in which the Group operates (“the functional currency”). The consolidated financial statements are presented in Ukrainian hryvnia (“UAH”), which is the Company’s functional and the Group’s presentation currency. All amounts presented in the consolidated financial statements are presented in UAH, rounded to the nearest million, if not otherwise stated.

Transactions denominated in currencies other than the relevant functional currency are translated into the functional currency, using the exchange rate prevailing at the date of the transaction. Foreign exchange gains and losses, resulting from settlement of such transactions and from the translation of foreign currency denominated monetary assets and liabilities at year end, are recognised in the consolidated statement of profit or loss. Translation at year end does not apply to non-monetary items including equity investments.

As at 31 December, the exchange rates used for translating foreign currency balances were:

<table>
<thead>
<tr>
<th>Functional currency</th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD 1.00</td>
<td>28.27</td>
<td>23.69</td>
</tr>
<tr>
<td>EUR 1.00</td>
<td>34.74</td>
<td>26.42</td>
</tr>
</tbody>
</table>

The average exchange rates for the year ended 31 December were:

In Ukrainian hryvnias

<table>
<thead>
<tr>
<th>Year</th>
<th>USD 1.00</th>
<th>EUR 1.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>26.96</td>
<td>30.79</td>
</tr>
<tr>
<td>2019</td>
<td>25.85</td>
<td>29.95</td>
</tr>
</tbody>
</table>

During 2020 and 2019 in Ukraine there were certain restrictions in respect of transactions with foreign currency imposed by the National Bank of Ukraine. Foreign currency can be easily converted at a rate close to the National Bank of Ukraine rate. At present, UAH is not freely convertible outside Ukraine.

Basis for consolidation. Subsidiaries are those companies over which the Group has control. The Group controls an entity when the Group has power over the investee; is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to use its power to affect its returns. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date that control ceases.

Intercompany transactions, balances and unrealised gains or losses on transactions between the Group companies are eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more elements of control listed above.

When the Group has a majority of the voting rights of an investee, it still considers whether the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally and, thus, has the power over the investee.

The Group considers all relevant facts and circumstances in assessing whether control exists, including voting patterns at previous shareholders’ meetings.

Business combinations. Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition date fair values of the assets transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition-related costs are generally recognised in profit or loss as incurred.
— deferred tax assets or liabilities, and assets or liabilities related to employee benefit arrangements are recognised and measured in accordance with IFRS 12 “Income Taxes” and IAS 19 “Employee Benefits”; respectively;
— liabilities or equity instruments related to share-based payment arrangements or the share-based payment arrangements of the Group entered to replace share-based payment arrangements of the acquiree are measured in accordance with IFRS 2 “Share-Based Payments” at the acquisition date; and
— Assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 “Disposal of Non-current Assets Held for Sale and Discontinued Operations” are measured in accordance with that Standard.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquiree’s previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquiree’s previously held interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the Group’s assets and liabilities at acquisition may be measured either at fair value or at the non-controlling interests’ proportionate share of the recognised amounts of the acquiree’s identifiable assets. The choice of measurement basis is made on a transaction-by-transaction basis. Other types of non-controlling interests are measured at fair value or, when applicable, on the basis of the acquired IFRS.

When the consideration transferred by the Group in a business combination includes assets or liabilities resulting from a contingent consideration, the contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination and accounted for as a separate asset or liability. Contingent consideration that qualifies as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the “measurement period” which cannot exceed one year from the acquisition date about facts and circumstances that existed at the acquisition date.

The subsequent accounting for changes in the fair value of the contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as an asset or a liability at acquisition and subsequently reports to subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an identifiable asset or liability at acquisition is reclassified to profit or loss. The fair value of the Group’s contingent consideration is recognised in the Group’s financial statements as soon as it is probable that the Group will receive a benefit from the sale of the project and the amount of benefit can be measured reliably.

When a business combination is achieved in stages, the Group’s previously held equity interest in the acquiree is remeasured to its fair value as at the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that are reclassified in profit or loss are measured at fair value and any comprehensive income are reclassified to profit or loss where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, provisional amounts are recognised for the items for the purposes of which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see above), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognised at that date.

Goodwill arising on an acquisition of a business is carried at cost as established at the date of acquisition of the business less accumulated impairment losses, if any.

For the purposes of impairment testing, goodwill is allocated to each of the Group’s cash-generating units (or groups of cash-generating units) that is expected to benefit from the synergies of the combination.

A cash-generating unit to which goodwill has been allocated is tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than its carrying amount, an impairment loss is recognised first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata based on their carrying amount in the unit. Any impairment loss for goodwill is recognised directly in profit or loss. An impairment loss recognised for goodwill is not reversed in subsequent periods.

On disposal of the relevant cash-generating unit, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Transactions with non-controlling interests. The Group treats transactions with non-controlling interests as transactions with equity owners of the Group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share of the acquired carrying amount of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

When the Group ceases to have control or significant influence, the retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in profit or loss. If the fair value is the initial carrying amount for the purposes of subsequent accounting for the retained interest in an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. If the Group ceases to have control or significant influence, the retained interest in the associate, joint venture or financial asset is measured at fair value, with the change in carrying amount recognised in profit or loss. If the fair value is the initial carrying amount for the purposes of subsequent accounting for the retained interest in an associate, joint venture or financial asset, any amounts previously recognised in other comprehensive income are reclassified to profit or loss.

The ownership interest in an associate is reduced but significant influence is appropriate, only a proportionate share of the amounts previously recognised in other comprehensive income revenue in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. If the Group ceases to have control or significant influence, the retained interest in the associate, joint venture or financial asset is measured at fair value, with the change in carrying amount recognised in profit or loss. If the fair value is the initial carrying amount for the purposes of subsequent accounting for the retained interest in an associate, joint venture or financial asset, any amounts previously recognised in other comprehensive income are reclassified to profit or loss.

If the ownership interest in an associate is reduced but significant influence is appropriate, only a proportionate share of the amounts previously recognised in other comprehensive income, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that are reclassified in profit or loss are measured at fair value and any comprehensive income are reclassified to profit or loss where such treatment would be appropriate if that interest were disposed of.

When a group entity transacts with a joint operation in which a group entity is a joint operator (such as a purchase of assets), the Group shall derecognise the share of the gains and losses until it resells those assets to a third party.

Concession agreement (product sharing agreement). The concession agreement with the Egyptian General Petroleum Corporation (“EGPC”) on 13 December 2006. The Concession Agreement includes the following conditions:
Any increase in the carrying amounts resulting from revaluation are credited to equity in reserve in equity through other comprehensive income. Decreases that offset previously recognised increases of the same asset are charged against revaluation reserve in equity through other comprehensive income; all other decreases are charged to the consolidated statement of profit or loss. To the extent that an impairment loss on an asset was previously recognised in the consolidated statement of profit or loss, a reversal of that impairment loss is also recognised in the consolidated statement of profit or loss.

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, is capitalised with the carrying amount of the replaced component being derecognised. Subsequent costs are included in the asset’s carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the consolidated statement of profit or loss during the financial period in which they are incurred. Property, plant and equipment are derecognised upon disposal or when no future economic benefits are expected to be received from the continued use of the asset. Gains and losses on disposal determined by comparing proceeds with carrying amount of property, plant and equipment are recognised in the consolidated statement of profit or loss. When revalued assets are sold or disposed of, the amounts included in revaluation reserve are transferred to retained earnings.

Property, plant and equipment includes cushion gas which is required to be disclosed. Cushion gas is a gas intended for maintaining pressure in underground storage facilities of the Group and protecting them from flooding. Cushion gas is considered to be partially recoverable based on an engineering analysis, and it will take several years and costs to pull it from underground storage facilities. When cushion gas is sold, the Company will have to cover costs to liquidate wells and other infrastructure. Cushion gas is revalued when there is evidence that the carrying amount of the reporting date is materially different from its fair value.

Construction in progress includes also prepayments for property, plant and equipment.

**Exploration expenses.** Exploration expenses comprise the costs associated with unproved reserves. These include geological and geophysical costs for the identification and investigation of areas with possible oil and gas reserves and administrative, legal and consulting costs in connection with exploration. They also include all impairments on exploration wells where no proved reserves could be demonstrated.

**Research and development expenses.** Research and development (“R&D”) expenses include all direct and indirect materials, personnel and external services costs incurred in connection with the focused search for new development techniques and significant improvements in products, services and processes and in connection with research activities. Expenditures related to research activities is shown as R&D expenses. However, expenditures related to development activities are capitalised if the recognition criteria according to IAS 38 “Intangible Assets” are fulfilled.

**Useful lives in years**

| Exploration, evaluation and drilling assets | 2-60 |
| Gas and oil upstream | 2-60 |
| Underground gas storages | 2-60 |
| Oil transmission system | 2-60 |
| Gas and oil refineries | 2-60 |
| Filling stations | 2-60 |
| Gas distribution assets | 2-60 |
| LNG transportation | 2-60 |
| Other fixed assets | 2-60 |

**Intangible assets.** Intangible assets have definite useful lives and primarily include licenses for exploration and extraction and capitalised computer software. Development costs are capitalised on the basis of the costs incurred to acquire and bring it to use. Intangible assets are carried at cost less accumulated amortisation and impairment losses, if any. If impairment loss on the carrying amount of the intangible asset is written down to the higher of value in use and fair value less costs to sell, intangible assets are amortised on a straight-line basis to allocate the costs of individual assets over their estimated useful lives.

**Lessees.** According to IFRS 16, the Group records assets in the form of the right-of-use and lease liabilities in the consolidated statement of financial position and measures at the present value of future lease payments that are not paid at the commencement date, discounted by using the risk-free rate specific to the lease. If this rate cannot be readily determined, the Group uses its incremental borrowing rate. The Group records depreciation of assets in the form of the right-of-use and interest on lease liability in the consolidated statement of profit or loss. Total amount of cash paid to principal is presented within financial activities in the consolidated statement of cash flows and interest are presented within financing activities. In respect of short-term leases (12 months or less) and lease with low value assets (such as personal laptops and office furniture), the Group records lease payments as operating expenses on a straight-line basis over the term of the lease.

**Lessor accounting** in which a significant portion of the risks and rewards of ownership are retained by the lessor is classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the consolidated statement of profit or loss on a straight-line basis over the period of the lease.

**Decommissioning liabilities.** The Group’s assessment of the decommissioning liabilities is based on the estimated future costs expected to be incurred in respect of the decommissioning and site restoration, adjusted for the effect of the projected inflation for the upcoming periods and discounted using interest rates applicable to the provisions. Estimated costs are based on several years and costs to be performed in the future. When a decommissioning liability is recognised, Changes in the measurement of an existing decommissioning liability, that result from changes in the estimated timing or amount of the liabilities, or from changes in the discount rate used for measurement, are recognised in the consolidated statement of profit or loss or, to the extent any revaluation balance exists in respect of the related asset, in other comprehensive income or loss. Provisions in respect of decommissioning activities are evaluated and re-estimated annually, and are included in the consolidated financial statements at each reporting date at their expected present value, using discount rates which reflect the economic environment in which the Group operates.

Interest expense related to the provision is included in financial costs in profit or loss.

**Impairment of non-financial assets.** Assets are reviewed for impairment when events and changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the assets carrying amount exceeds its recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. For purposes of assessing recoverable amount, assets are grouped to the lowest levels for which there are separately identifiable cash flows (carrying amount). Non-financial assets that have incurred impairment are reviewed for possible reversal on a regular basis of at least annually.

An impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been recognised had no impairment loss been recognised for the asset (or cash generating unit) in prior years. A reversal of an impairment loss is recognised immediately in the consolidated statement of profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

**Financial Instruments.** The Group has adopted IFRS 9 from 1 January 2018. Financial assets and financial liabilities are initially recognised at fair value minus any transaction costs.

The Group’s principal financial instruments comprise borrowings, cash and bank balances, trade accounts receivables and trade accounts payables, state treasury bonds and consideration receivable under the SPA (Note 20).

All purchases and sales of financial instruments that require delivery within the time frame established by regulation or market convention (“regular way” purchases and sales) are recorded at trade date basis, which is the date that the Group commits to deliver or accept delivery. All other purchases and sales are recognised on the settlement date.

**Classification and subsequent measurement of financial assets.** The Group classifies financial assets into one of three categories: loans and receivables, held-to-maturity assets and available-for-sale financial assets.

**Amortised cost** is the cost to the Group of acquiring an asset or asset group less any proceeds from disposition. Loans and receivables and held-to-maturity financial assets are subsequently measured at amortised cost, which is the cost basis with interest income recognised using the effective interest method. The difference between the cost of the financial assets and the cash inflows expected to be recovered by the Group is recognised in profit or loss or other comprehensive income, as the case may be. Loan and receivable losses are recognised immediately in profit or loss.

Held-to-maturity assets are subsequently measured at amortised cost, with interest income recognised using the effective interest method. Loan and receivable losses are recognised immediately in profit or loss.

Available-for-sale assets are subsequently measured at fair value. Loan and receivable losses are recognised immediately in profit or loss only if there is an indicator that the recovery of the fair value is unlikely. If a financial asset has been previously impaired, the impairment is reversed when it is determined that the asset has recovered.

**Impairment testing.** Impairment testing is required at each reporting date. Impairment losses are recognised in profit or loss. The impairment test is performed by comparing the recoverable amount of the asset or cash generating unit to its carrying amount.

**Bank deposits.** The Group’s bank deposits, included in financial assets at amortised cost, are held in accounts that are insured within the limits of their respective insurance limits.

**Financial assets at fair value through profit or loss.** The Group classifies all its financial assets at fair value through profit or loss, and their changes are recognised in profit or loss. The Group’s financial assets at fair value through profit or loss include derivative financial instruments, foreign currency denominated financial instruments and listed financial assets.

**Principal risks and rewards.** The principal risks and rewards of ownership associated with the financial assets and liabilities at fair value through profit or loss include the risk of fluctuations in interest rates, currency exchange rates, market values and credit risk.

**Financial derivatives.** The Group uses derivative financial instruments to manage its financial risks. The Group’s risk management policy includes an investment in a diversified portfolio of high quality liquid assets that may include financial derivative instruments.

**Foreign currency risk.** The Group is exposed to changes in exchange rates. The Group uses derivative financial instruments to manage its foreign currency risk.

**Credit risk.** The Group is exposed to credit risk in respect of cash and cash equivalents, trade receivables, trade payables, financial instruments and derivative financial instruments.

The Group sets limits relating to the credit risk associated with its financial assets and derivative financial instruments. The Group’s credit risk exposure is monitored and controlled in order to limit its financial losses from defaults on financial assets and derivative financial instruments.
Prepayments made and other current assets. Prepayments are carried at cost excluding VAT less provision for impairment. A prepayment is classified as a current asset when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset that will itself be classified as non-current upon initial recognition.

If there is an indication that the assets, goods or services relating to a prepayment will not be obtained, then the Group recognises provision for impairment in respect of such prepayment made and a corresponding impairment loss is recognised. Prepayments are subsequently reclassified to other assets.

Promissory notes. Some purchases may be settled by promissory notes or bills of exchange, which are negotiable debt instruments. Purchases settled by promissory notes are recognised based on management’s estimate of the fair value to be given up in such settlements. The fair value is determined with reference to observable market information.

State treasury bonds. The State treasury bonds are initially measured at fair value plus transaction costs directly attributable to acquisition of such financial assets. The State treasury bonds are subsequently measured at fair value through profit or loss.

Cash and cash equivalents. Cash and cash equivalents include cash on hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest rate method. Restricted cash balances are excluded from cash and cash equivalents for the purposes of the statement of financial position, when initially recognised, affects neither accounting nor taxable profit. Deferred tax liabilities are not recorded for temporary differences on initial recognition of a financial asset or a liability in a transaction other than a business combination. The Group had not recognised deferred tax liabilities.

In accordance with the initial recognition exemption, deferred tax assets are not recorded for temporary differences on initial recognition of a financial asset or a liability in a transaction other than a business combination.

The Group has a fixed maturity re-measured at amortised cost using the effective interest rate method. Bank overdrafts are included into borrowings line item in the consolidated statement of financial position.

Trade accounts payable. Trade accounts payable are recognised and initially measured under the policy for financial instruments mentioned above. Subsequently, instruments with a fixed maturity are re-measured at amortised cost using the effective interest rate method. Bank overdrafts are included into borrowings line item in the consolidated statement of financial position.

Advances received. Advances received are carried at amounts originally received excluding VAT. Amounts of advances related to the early extinguishment of financial liabilities are recognised in the revenue received from usual activities of the Group.

Provisions. Provisions are recognised when the Group has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. A provision is not recognised if it relates to a material contract.

Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursable amount is recognised as a current asset. Trade accounts payable are recognised and initially measured under the policy for financial instruments mentioned above. Subsequently, instruments with a fixed maturity are re-measured at amortised cost using the effective interest rate method. Bank overdrafts are included into borrowings line item in the consolidated statement of financial position.

The expense on any provision is presented in the consolidated statement of financial position as a financial liability without needing to impose additional restrictions on the sale. The Group derecognises financial liabilities when and only when, the Group’s obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

Income taxes. Income taxes have been provided for in the consolidated statement of profit or loss calculated in accordance with Ukrainian legislation enacted or substantively enacted by the end of the reporting date. The income tax charge comprises current tax and deferred tax and is recognised in the consolidated statement of profit or loss unless it relates to transactions that are recognised, in the same or a different period, in other comprehensive income or directly in equity.

Current tax is the amount expected to be paid or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. The amount expected to be paid or recovered from the taxation authorities in respect of taxable profits or losses for the current period is recognised in profit or loss.

Deferred income tax is provided using the balance sheet liability method for tax losses carried forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recognised, affects neither accounting nor taxable profit. Deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill acquired in a business combination.

The Group derecognises assets and liabilities when an impairment loss has been recognised. Where the impairment loss is attributable to an asset or a liability, the amount of the impairment loss is removed from equity and recognised in the consolidated statement of profit or loss.

Impairment losses on equity instruments are not reversed through the consolidated statement of profit or loss. Impairment of financial assets. The Group applies the simplified approach to recognise write-downs expected loss provisions for financial assets, as permitted by IFRS 9. The Group accounts for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition.

The expected credit losses are estimated using a migration matrix by reference to past default experience of the debtor and an analysis of the debtor’s current position. In order to use this method, the Group’s counterparties were grouped with uniform credit risk levels, for which expected credit losses were calculated by the Group. The Group recognises 100% provision for impairment on trade accounts receivable for more than 12 months or 365 days of receivables that entered bankruptcy, liquidation or financial reorganisation, and counterparty receivables that are located on temporary non-current assets list.

According to historical experience, the probability of returning such receivables is extremely low.

The carrying amount of the asset is reduced through the provision, and the amount of respective loss is recognised in the consolidated statement of profit or loss and included to net movement in non-current assets line. When receivables are uncollectible, they are written off against the provision account for receivables. Subsequent recovery of amounts previously written off are credited to the consolidated statement of profit or loss.

Classification and subsequent measurement of financial instruments. Financial assets that are at (i) contingent consideration of an acquirer in a business combination, (ii) held for trading, or (iii) designated as at FVTPL, are measured at amortised cost or fair value through profit or loss (“PVTP”). Financial liabilities that are not (i) contingent consideration of an acquirer in a business combination, (ii) held for trading, or (iii) designated as at FVTPL, are measured subsequently at amortised cost using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees and points paid or received, transaction costs and other premiums or discounts) throughout the expected life of the financial liability, or where appropriate) a shorter period, to the amortised cost of a financial liability.

Trade accounts receivable. Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

Dividends and mandatory budget contribution of profit share. Dividends and mandatory budget contribution of profit share are recognised as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or declared after the reporting date but before the consolidated financial statements are authorised for issue.

Value added tax (“VAT”). In Ukraine VAT is levied at two rates: 20% on sales and imports of goods, works and services within the country, and 9% on the export of goods and limited list of services (e.g. international transportation). A taxpayer’s VAT liability equals the total amount of VAT accrued within the reporting period, and arises on the earlier of the date of shipping goods or rendering services to a customer or the date of receiving payment from the customer. A VAT input is the amount that the taxpayer is entitled to offset against his liability in a reporting period. Rights to VAT input arise when a VAT invoice is received, which is issued on the earlier of the date of payment to the supplier or the date the goods are received or services are rendered. VAT related to sales and purchases is recognised in the consolidated statement of financial position on a gross basis and disclosed separately as an asset and liability. Where provision has been made for VAT on returns of intangible assets, the corresponding amount is recorded for the gross amount of the debtor, including VAT, except provision for impairment of prepayments made.

Bank overdrafts. Bank overdrafts include bank borrowings and bank loans. Borrowing costs. Borrowing costs directly attributable to the acquisition of a financial asset, which are assets that are subject to a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets. Borrowing costs on financial assets that are substantially ready for their intended use or sale. All other borrowing costs are recognised in consolidated statement of profit or loss in the period in which they are incurred.

Borrowings are initially recognised at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortised cost using the effective interest rate method. Bank overdrafts are included into borrowings line item in the consolidated statement of financial position.

In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of goodwill acquired in a business combination.

Deferred tax liabilities are not recorded for temporary differences on initial recognition of a financial asset or a liability in a transaction other than a business combination if the transaction, when initially recognised, affects neither accounting nor taxable profit. Deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill acquired in a business combination.

The Group derecognises assets and liabilities when an impairment loss has been recognised. Where the impairment loss is attributable to an asset or a liability, the amount of the impairment loss is removed from equity and recognised in the consolidated statement of profit or loss.

Receivables. Receivables are measured at amortised cost using the effective interest rate method. Where a change in the effective interest rate becomes effective, the carrying amount of receivables at the new effective interest rate is determined based on the unamortised carrying amount at the date of change and the remaining period until the receivable is due for repayment.

The Group derecognises financial assets when (i) the assets are redeemed or the rights to cash flows from the assets have otherwise expired, (ii) the Group has transferred substantially all the risks and rewards of ownership of the assets or (iii) the Group has neither transferred nor retained substantially all risks and rewards of ownership but has not retained control. Control is retained if the counterparty has the ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale. The Group derecognises financial assets when, and only when, the Group’s obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

Investments. Investments in subsidiaries and associates are initially measured at cost. Where the Group has the power to govern the经营 decisions of an associated entity, the Group measures investments at initial acquisition at fair value. The resulting difference between the purchase price and the fair value of the investment is recognised as a gain or loss in the consolidated statement of profit or loss.

Subsequent to initial recognition, investments are measured at cost, less any impairment loss, or (where appropriate) a shorter period, to the amortised cost using the effective interest method, less provision for impairment. Investments are derecognised when control, joint control or significant influence is lost. The difference between the carrying amount of the investment derecognised and the proceeds from the sale or discharge of the investment is recognised in profit or loss.
or as a performance obligation is satisfied, i.e., when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer. Revenue from the sale of gas which is transported through gas transmission system is recognised when the gas has been delivered at delivery point to the customer. Revenue from sale of petroleum products is recognised when the title passes to the customer. Delivery occurs when the goods have been shipped to the specified location, the risks of obsolescence and loss have been transferred to the customer, and either the customer has accepted the goods in accordance with the contract, the acceptance provisions have lapse, or the Company has objective evidence that all criteria for acceptance have been satisfied.

Revenue gross versus net presentation. When the Group acts as a principal, revenue, production costs and purchases are reported on a gross basis. If the Group sells goods or services as an agent, revenue is recorded on a net basis, representing the margin/commission earned. Whether the Group is considered to be a principal or an agent in a transaction depends on the analysis of both legal form and substance of the agreement the Group enters into.

As discussed in Note 3, at the end of 2019 the Company and “Gazprom” JSC signed an agreement on servicing gas transit through the territory of Ukraine. In turn, Naftogaz signed an agreement on gas transmission services from “Gas Transmission System Operator of Ukraine” JSC. The Company is considered to be a principal in this transaction based on the following criteria: — it is a primarily responsible party for fulfilling the promise to a customer; — it bears the risk of price change for transmission services through the territory of Ukraine.

Revenues are recorded on an accrual basis. Costs incurred in process of production, storage, distribution and transportation of hydrocarbons are classified as Production expenses. Production related costs include cost of gas transit organization services, cost of gas and other similar expenses.

Compensation for performing public service obligations. As described in Note 2, the Company is eligible for compensation for performing public service obligations. The management concluded that such compensation is needed in assessing an appropriate discount rate. Key sources of estimation uncertainty are the amount of compensation allowed to customers, and available market information regarding the counterparty’s ability to pay. Should actual results be less than management’s estimates, the Company would be required to record an additional impairment expense.

As at 31 December 2020, the Group accrued a provision for impairment of financial assets in amount of UAH 1,937 million (2019: UAH 2,281 million) (Note 10). The Group recalculated the impairment loss for the carrying amount of financial assets in amount of UAH 1,937 million using the relevant financial assets in the Group’s balance sheet as at 31 December 2020.

The Company recognised the government assistance when the aid was not conditional on the amount of performance. The Group is eligible for compensation for performing public service obligations. The management concluded that such compensation is needed in assessing an appropriate discount rate. Key sources of estimation uncertainty are the amount of compensation allowed to customers, and available market information regarding the counterparty’s ability to pay. Should actual results be less than management’s estimates, the Company would be required to record an additional impairment expense.

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there are no long-term, high quality corporate or government bonds issued in Ukrainian hryvnia, significant appreciation or depreciation of the corporate discount rate.

Key assumptions are presented in Note 13.

Decommissioning costs. The decommissioning provision represents an estimate of the decommissioning costs related to oil and gas properties, which are expected to be incurred in the future (Note 13). These provisions were recognised, based on management's internal estimates.

Main estimates include future market prices for the necessary decommissioning costs, and are based on market conditions and factors such as parameters relate to the timing of the decommissioning costs, which depends on depletion of the fields, future oil and gas prices and as a result – expected point of time, when there are no further economic benefits in the production.

Changes in these estimates can lead to the material changes in the provisions recognised in the consolidated statement of financial position.

Depletion of the oil and gas assets. Oil and gas assets are depleted using a unit-of-production method. The cost of the wells is amortised based on the proved volumes of available reserves, estimated in accordance with the standards of the Petroleum Resource Management System (PRMS) prepared by the Oil and Gas Reserves Committee of Society of Petroleum Engineers (SPE). The estimation of hydrocarbons reserves is carried out in general on the field. Respectively, all wells of the field are depreciated based on the total volume of extracted from the field specific type of hydrocarbons for the period and the balances of reserves are allocated to the field are depreciated based on the total volume of extracted hydrocarbons generating units and, accordingly, the recorded impairment of property, plant and equipment in a total amount of UAH 1,714 million (Note 5).

Major assumptions used in estimating the recoverable amount include judgments regarding discount rates, UAH/EUR exchange rates, and estimated changes in volumes of gas and oil transit and transportation. Management has determined the discount rate by using the after tax rate that reflects current market investment rates with similar risk levels. To project UAH/ EUR exchange rate, the Company has used conservative forecasts of analytical agencies. Movements in the volumes of gas and oil transit and transportation are based on the assumptions regarding industry developments and expectations on further market changes. Numerical values of key judgments of the Group’s management reflect their estimation of future business trends; they are based on both internal and external sources of the Group.

In making the assessment for general impairment, assets that do not generate independent cash flows are allocated to an appropriate cash–generating unit. Indicators of a potential impairment include analysis of market conditions, asset utilisation and the impact of the asset for alternative purposes. If an indication of impairment exists, the Group estimates the recoverable value (greater of fair value less cost to sell and value in use) of the cash–generating unit, and records impairment to the extent the carrying value is greater than the recoverable amount.

Useful lives of property, plant and equipment. The Group's property, plant, and equipment, except oil and gas assets, are amortised using straight-line method over their estimated useful lives, which are based on management’s business plans and operational estimates.

The Group reviews the estimated useful lives of property, plant and equipment at the end of each annual reporting period. The review is based on the current condition of the assets and the estimated period during which they will continue to bring economic benefit to the Group. Any change in estimated useful life or residual value is recorded on a prospective basis from the date of the change.

Inventory valuation. Inventory is stated at lower of cost or net realisable value. In assessing the net realisable value of its inventories, management bases its estimates on various assumptions including market prices. At each reporting date, the Group evaluates its inventories for excess quantities and obsolescence and, if necessary, records an allowance to reduce inventories for obsolete and slow moving goods. This allowance requires assumptions related to future inventories use. These assumptions are based on inventories ageing and forecasted demand. Any changes in estimates may impact the amount of the allowances for inventory that may be required.

The Group engaged independent appraisers to determine the fair value of its major groups of property, plant and equipment as at 1 January 2019, and as at 1 December 2020 for “Oil transmission system”.

Management also reviews carrying amounts of property, plant and equipment to determine whether there are any indicators that these assets are impaired. Based on the analysis performed as at 31 December 2020, the management of the Group identified impairments to the certain groups of property, plant and equipment. The Group has engaged an independent appraiser for testing the existence of economic impairment of relevant cash–generating units and, accordingly, recorded the impairment of property, plant and equipment in total amount of UAH 1,714 million (Note 5).

27. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS
Adoption of new and revised International Financial Reporting Standards. The following standards have been adopted by the Group for the first time for the financial year ending on or after 1 January 2020:

— Amendments to IAS 1 "Presentation of Financial Statements" and IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". Definition of Material; Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures". Amendments regarding the sale or contribution of assets between an investor and its associate or joint venture.

To be determined

Management anticipates that adoption of new Standards and Interpretations in future periods will not have a material effect on the consolidated financial statements of the Group in future periods.
About the report

Naftogaz Group strives to provide transparent and open information on the results of its activities and impact on society, the environment and the economic situation in the country. To this end, the Company prepares an annual report that highlights the most important financial and non-financial results.

This Annual Report discusses information on the activities of the Naftogaz Group in 2020. This is the sixth report of the Naftogaz Group, which was prepared under the GRI (Global Reporting Initiative) standards according to the requirements of the «Basic» version of the disclosure. To ensure the proper quality of the report, the company was guided by the following principles of the GRI Standards:

— Accuracy;
— Balance;
— Comparability;
— Timeliness;
— Clarity;
— Reliability.

In identifying the priority topics to be disclosed in the annual report, we are guided by the principles of the GRI Standard for determining the content of the report, namely:

Interaction with stakeholders

One of the fundamental criteria for determining the content of the report for the Naftogaz Group is the interest and concern of our stakeholders. The official website of the company publishes the Procedure for interaction with stakeholders, which describes the goals and principles of interaction with stakeholders. This document certifies the list of stakeholders, which describes the goals and principles of interaction with stakeholders. The list of stakeholders is reviewed annually and updated as necessary.

Sustainable development context

Naftogaz Group aims to contribute to the achievement of sustainable development goals and annually discloses both positive and negative results of its activities in the economic, social and environmental context. The annual report presents data on the direct impacts of the company, as well as outlines the actual and potential indirect impacts of its activities at the local and national levels.

Significance

In its Annual Report, the Naftogaz Group reveals the issues that are most important to stakeholders and reflect the most significant aspects of its activities in the economic, social and environmental spheres. All identified significant topics are evaluated for their significance in the context of sustainable development and importance for the company with the following tools:

— Analysis of the external information field of the company;
— Analysis of annual non-financial reports of the peer Ukrainian and foreign companies;
— Consultations with the representatives of internal structural divisions and subsidiaries of the Naftogaz Group;
— Consultations with the representatives of the top management of the company;
— Analysis of international standards, agreements, resolutions in the field of sustainable development, for example, the UN Sustainable Development Goals.

For each of the significant topics, their scope is determined, including list of structural and organizational units of the company (subsidiaries, joint ventures), the results of their activities to be disclosed in the report on each topic.

The list of significant topics is reviewed annually and updated as necessary. The table below lists the significant topics and their scopes identified in the 2020 reporting process.

Completeness

The Report provides detailed information on the Naftogaz Group’s activities in the economic, social and environmental spheres within the significant topics and determined scopes. With such approach, the stakeholders receive the fullest possible presentation of the company’s results. The undistorted and comprehensive disclosure facilitates the decision-making process for all stakeholders based on transparent and complete information about the goals, impacts and consequences of the company’s activities. To ensure the proper level of completeness of the information disclosed in the report, Naftogaz Group focuses not only on the current reporting period (01.01.2020 – 31.12.2020), but also describes historical and expected market trends in Ukraine and the world, potential short-term and long-term impacts of its activities on society and the environment.

Significant topics and their scopes

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**GRI Disclosures 2016. Stakeholder engagement**

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<td>Aniha Osmolovska, Naftogaz Group director of GR and stakeholder relations</td>
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<tr>
<td>303-2</td>
<td>Management of water discharge-related impacts</td>
<td>170</td>
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<td>GRI 304: Biodiversity 2016</td>
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<td>Significant impacts of activities, products, and services on biodiversity</td>
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<td>New employee hires and employee turnover</td>
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<td>Human resources management indicator has been partially disclosed</td>
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<td>401-2</td>
<td>Benefits provided to full-time employees that are not provided to temporary or part-time employees</td>
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<td>402-1</td>
<td>Minimum notice periods regarding operational changes</td>
<td>128</td>
<td>According to the current legislation of Ukraine, such a period is 2 months. The relevant norm is enshrined in collective agreements.</td>
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--- | --- | --- | --- | ---
GRI 403: Occupational Health and Safety 2018 | GRI 103: Management Approach 2016 | 134 | Occupational health and safety (OHS)
403-1 | Occupational health and safety management system | 134 | Occupational health and safety (OHS)
403-2 | Hazard identification, risk assessment, and incident investigation | 134 | Occupational health and safety (OHS)
403-3 | Occupational health services | 135 | Occupational health and safety (OHS)
403-4 | Worker participation, consultation, and communication on occupational health and safety | 134 | Occupational health and safety (OHS)
403-5 | Worker training on occupational health and safety | 134 | Occupational health and safety (OHS)
403-6 | Promotion of worker health | 134 | Occupational health and safety (OHS)
403-7 | Prevention and mitigation of occupational health and safety impacts directly linked by business relationships | 134 | Occupational health and safety (OHS)
403-8 | Workers covered by an occupational health and safety management system | 134 | Occupational health and safety (OHS)
403-9 | Work-related injuries | 134 | Occupational health and safety (OHS)
403-10 | Work-related ill health | 134 | Occupational health and safety (OHS)

GRI 404: Training and Education 2016 | GRI 103: Management Approach 2016 | 128 | Human resources management
404-1 | Average hours of training per year per employee | 128 | Human resources management
404-2 | Programs for upgrading employee skills and transition assistance programs | 128 | Human resources management

GRI 405: Diversity and Equal Opportunity 2016 | GRI 103: Management Approach 2016 | 128 | Human resources management
405-1 | Diversity of governance bodies and employees | 128 | Human resources management

GRI 406: Non-discrimination 2016 | GRI 103: Management Approach 2016 | 128 | Human resources management
406-1 | Incidents of discrimination and corrective actions taken | - | In 2020 there were no registered incidents of discrimination.